

SALISBURY BANCORP INC  
Form 10-Q  
August 08, 2018

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**For the quarterly period ended June 30, 2018**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission file number 0-24751

**SALISBURY BANCORP, INC.**

(Exact name of registrant as specified in its charter)

**Connecticut**  
(State or other jurisdiction  
of incorporation or organization)

**06-1514263**  
(I.R.S. Employer  
Identification No.)

**5 Bissell Street, Lakeville, CT**  
(Address of principal executive offices)

**06039**  
(Zip code)

**(860) 435-9801**

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer   Accelerated filer   Non-accelerated filer   Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Common Stock outstanding as of August 8, 2018 is 2,804,881.

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**PART I - FINANCIAL INFORMATION****Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED BALANCE SHEETS**

| (dollars in thousands, except share data)                                | June 30, 2018<br>(unaudited) | December 31, 2017 |
|--------------------------------------------------------------------------|------------------------------|-------------------|
| <b>ASSETS</b>                                                            |                              |                   |
| Cash and due from banks                                                  | \$5,953                      | \$9,357           |
| Interest bearing demand deposits with other banks                        | 71,520                       | 39,129            |
| Total cash and cash equivalents                                          | 77,473                       | 48,486            |
| Securities                                                               |                              |                   |
| Available-for-sale at fair value                                         | 85,057                       | 78,212            |
| CRA mutual fund                                                          | 825                          | 835               |
| Federal Home Loan Bank of Boston stock at cost                           | 4,988                        | 3,813             |
| Loans held-for-sale                                                      | 206                          | 669               |
| Loans receivable, net (allowance for loan losses: \$7,381 and \$6,776)   | 872,796                      | 801,703           |
| Other real estate owned                                                  | 478                          | 719               |
| Bank premises and equipment, net                                         | 18,811                       | 16,401            |
| Goodwill                                                                 | 13,815                       | 13,815            |
| Intangible assets (net of accumulated amortization: \$4,279 and \$4,043) | 1,601                        | 1,837             |
| Accrued interest receivable                                              | 3,025                        | 2,665             |
| Cash surrender value of life insurance policies                          | 14,544                       | 14,381            |
| Deferred taxes                                                           | 1,101                        | 677               |
| Other assets                                                             | 2,060                        | 2,771             |
| Total Assets                                                             | \$1,096,780                  | \$986,984         |
| <b>LIABILITIES and SHAREHOLDERS' EQUITY</b>                              |                              |                   |
| Deposits                                                                 |                              |                   |
| Demand (non-interest bearing)                                            | \$215,149                    | \$220,536         |
| Demand (interest bearing)                                                | 147,120                      | 142,575           |
| Money market                                                             | 228,918                      | 190,953           |
| Savings and other                                                        | 172,701                      | 144,600           |
| Certificates of deposit                                                  | 133,593                      | 116,831           |
| Total deposits                                                           | 897,481                      | 815,495           |
| Repurchase agreements                                                    | 1,691                        | 1,668             |
| Federal Home Loan Bank of Boston advances                                | 79,538                       | 54,422            |
| Subordinated debt                                                        | 9,823                        | 9,811             |
| Note payable                                                             | 297                          | 313               |
| Capital lease liability                                                  | 3,147                        | 1,835             |
| Accrued interest and other liabilities                                   | 5,623                        | 5,926             |
| Total Liabilities                                                        | 997,600                      | 889,470           |
| Shareholders' Equity                                                     |                              |                   |
| Common stock - \$0.10 per share par value                                |                              |                   |
| Authorized: 5,000,000;                                                   |                              |                   |
| Issued: 2,885,788 and 2,872,578                                          |                              |                   |
| Outstanding: 2,803,126 and 2,785,216                                     | 280                          | 279               |
| Unearned compensation - restricted stock awards                          | (983                         | ) (606            |
| Paid-in capital                                                          | 43,727                       | 42,998            |

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|                                                    |             |           |
|----------------------------------------------------|-------------|-----------|
| Retained earnings                                  | 57,002      | 54,664    |
| Accumulated other comprehensive (loss) income, net | (846        | ) 179     |
| Total Shareholders' Equity                         | 99,180      | 97,514    |
| Total Liabilities and Shareholders' Equity         | \$1,096,780 | \$986,984 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

## Salisbury Bancorp, Inc. and Subsidiary

## CONSOLIDATED STATEMENTS OF INCOME (unaudited)

| Periods ended June 30, (in thousands, except per share amounts)  | Three months ended |         | Six months ended |          |
|------------------------------------------------------------------|--------------------|---------|------------------|----------|
|                                                                  | 2018               | 2017    | 2018             | 2017     |
| Interest and dividend income                                     |                    |         |                  |          |
| Interest and fees on loans                                       | \$9,007            | \$8,126 | \$17,656         | \$16,347 |
| Interest on debt securities:                                     |                    |         |                  |          |
| Taxable                                                          | 532                | 354     | 992              | 672      |
| Tax exempt                                                       | 29                 | 113     | 61               | 277      |
| Other interest and dividends                                     | 181                | 94      | 340              | 176      |
| Total interest and dividend income                               | 9,749              | 8,687   | 19,049           | 17,472   |
| Interest expense                                                 |                    |         |                  |          |
| Deposits                                                         | 997                | 578     | 1,774            | 1,094    |
| Repurchase agreements                                            | 1                  | 1       | 3                | 1        |
| Capital lease                                                    | 48                 | 20      | 83               | 37       |
| Note payable                                                     | 4                  | 5       | 9                | 7        |
| Subordinated debt                                                | 156                | 156     | 312              | 312      |
| Federal Home Loan Bank of Boston advances                        | 500                | 266     | 833              | 528      |
| Total interest expense                                           | 1,706              | 1,026   | 3,014            | 1,979    |
| Net interest and dividend income                                 | 8,043              | 7,661   | 16,035           | 15,493   |
| Provision for loan losses                                        | 467                | 364     | 793              | 716      |
| Net interest and dividend income after provision for loan losses | 7,576              | 7,297   | 15,242           | 14,777   |
| Non-interest income                                              |                    |         |                  |          |
| Trust and wealth advisory                                        | 949                | 892     | 1,843            | 1,746    |
| Service charges and fees                                         | 892                | 902     | 1,760            | 1,863    |
| (Losses) gains on sales of mortgage loans, net                   | (1 )               | 30      | 17               | 79       |
| Mortgage servicing, net                                          | 84                 | 31      | 167              | 76       |
| Losses on CRA mutual fund                                        | (7 )               | —       | (20 )            | —        |
| Gain (losses) on available-for-sale securities, net              | 17                 | (14 )   | 16               | (14 )    |
| Other                                                            | 124                | 110     | 249              | 223      |
| Total non-interest income                                        | 2,058              | 1,951   | 4,032            | 3,973    |
| Non-interest expense                                             |                    |         |                  |          |
| Salaries                                                         | 2,939              | 2,668   | 5,785            | 5,437    |
| Employee benefits                                                | 969                | 831     | 2,128            | 1,919    |
| Premises and equipment                                           | 1,101              | 907     | 2,125            | 1,802    |
| Data processing                                                  | 556                | 504     | 1,042            | 977      |
| Professional fees                                                | 611                | 764     | 1,230            | 1,481    |
| OREO gains, (losses) and (write-downs)                           | 1                  | —       | 53               | 145      |
| Collections and other real estate owned                          | 235                | 155     | 316              | 312      |
| FDIC insurance                                                   | 123                | 98      | 253              | 247      |
| Marketing and community support                                  | 222                | 152     | 463              | 403      |
| Amortization of core deposit intangibles                         | 116                | 126     | 236              | 253      |
| Other                                                            | 544                | 546     | 965              | 1,079    |
| Total non-interest expense                                       | 7,417              | 6,751   | 14,596           | 14,055   |
| Income before income taxes                                       | 2,217              | 2,497   | 4,678            | 4,695    |
| Income tax provision                                             | 318                | 615     | 763              | 1,208    |

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|                                                                                     |         |         |         |         |
|-------------------------------------------------------------------------------------|---------|---------|---------|---------|
| Net income                                                                          | \$1,899 | \$1,882 | \$3,915 | \$3,487 |
| Net income allocated to common stock                                                | \$1,877 | \$1,867 | \$3,873 | \$3,461 |
| Basic earnings per common share                                                     | \$0.68  | \$0.68  | \$1.40  | \$1.26  |
| Weighted average common shares outstanding, to calculate basic earnings per share   | 2,762   | 2,757   | 2,760   | 2,753   |
| Diluted earnings per common share                                                   | \$0.68  | \$0.67  | \$1.39  | \$1.25  |
| Weighted average common shares outstanding, to calculate diluted earnings per share | 2,779   | 2,775   | 2,780   | 2,772   |
| Common dividends per share                                                          | \$0.28  | \$0.28  | \$0.56  | \$0.56  |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

**Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)**

| Periods ended June 30, (in thousands)                                                        | Three months ended |          | Six months ended |          |
|----------------------------------------------------------------------------------------------|--------------------|----------|------------------|----------|
|                                                                                              | 2018               | 2017     | 2018             | 2017     |
| Net income                                                                                   | \$ 1,899           | \$ 1,882 | \$ 3,915         | \$ 3,487 |
| Other comprehensive (loss) income                                                            |                    |          |                  |          |
| Net unrealized (losses) gains on securities available-for-sale                               | (279 )             | 106      | (1,297)          | 122      |
| Reclassification of net realized losses (gains) and write-downs in net income <sup>(1)</sup> | (17 )              | 14       | (16 )            | 14       |
| Unrealized (losses) gains on securities available-for-sale                                   | (296 )             | 120      | (1,313)          | 136      |
| Income tax benefit (expense)                                                                 | 62                 | (40 )    | 272              | (46 )    |
| Unrealized (losses) gains on securities available-for-sale, net of tax                       | (234 )             | 80       | (1,041)          | 90       |
| Comprehensive income                                                                         | \$ 1,665           | \$ 1,962 | \$ 2,874         | \$ 3,577 |

(1) Reclassification adjustments include realized security gains and losses. The gains and losses have been reclassified out of other comprehensive (loss) income and have affected certain lines in the consolidated statements of income as follows: The pre-tax amount is reflected as gains on sales and calls of available-for-sale securities, net, the tax effect is included in the income tax provision and the after tax amount is included in net income. The net tax effect for the three months ending June 30, 2018 and 2017 are \$6 thousand and \$5 thousand respectively. The net tax effect for the six month periods ending June 30, 2018 and 2017 are \$3 thousand and \$5 thousand, respectively.

**Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited) Six months ended June 30, 2018 and 2017**

| (dollars in thousands)                           | Common Stock |        | Paid-in capital | Retained earnings | Unearned compensation   | Accumulated other comp- | Total shareholders' equity |
|--------------------------------------------------|--------------|--------|-----------------|-------------------|-------------------------|-------------------------|----------------------------|
|                                                  | Shares       | Amount |                 |                   | restricted stock awards | rehensive income        |                            |
| Balances at December 31, 2016                    | 2,758,086    | \$ 276 | \$ 42,085       | \$ 51,521         | \$ (352 )               | \$ 477                  | \$ 94,007                  |
| Net income for period                            | —            | —      | —               | 3,487             | —                       | —                       | 3,487                      |
| Other comprehensive income, net of tax           | —            | —      | —               | —                 | —                       | 90                      | 90                         |
| Common stock dividends declared                  | —            | —      | —               | (1,555 )          | —                       | —                       | (1,555 )                   |
| Stock options exercised                          | 12,150       | 1      | 312             | —                 | —                       | —                       | 313                        |
| Issuance of restricted stock awards              | 10,950       | 2      | 426             | —                 | (428 )                  | —                       | —                          |
| Forfeiture of restricted stock awards            | (200 )       | —      | (3 )            | —                 | 3                       | —                       | —                          |
| Issuance of vested common stock for directors    | 2,056        | —      | 81              | —                 | —                       | —                       | 81                         |
| Issuance of director's restricted stock awards   | 2,024        | —      | 83              | —                 | (83 )                   | —                       | —                          |
| Stock based compensation-restricted stock awards | —            | —      | —               | —                 | 122                     | —                       | 122                        |
| Balances at June 30, 2017                        | 2,785,066    | \$ 279 | \$ 42,984       | \$ 53,453         | \$ (738 )               | \$ 567                  | \$ 96,545                  |
| Balances at December 31, 2017                    | 2,785,216    | \$ 279 | \$ 42,998       | \$ 54,664         | \$ (606 )               | \$ 179                  | \$ 97,514                  |
| Net income                                       | —            | —      | —               | 3,915             | —                       | —                       | 3,915                      |



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|                                                  |           |        |          |          |           |           |           |
|--------------------------------------------------|-----------|--------|----------|----------|-----------|-----------|-----------|
| Adoption of ASU 2016-01                          | —         | —      | —        | (16 )    | —         | 16        | —         |
| Other comprehensive loss, net of tax             | —         | —      | —        | —        | —         | (1,041 )  | (1,041 )  |
| Common stock dividends declared                  | —         | —      | —        | (1,561 ) | —         | —         | (1,561 )  |
| Issuance of restricted stock awards              | 9,250     | —      | 410      | —        | (410 )    | —         | —         |
| Stock options exercised                          | 4,700     | 1      | 144      | —        | —         | —         | 145       |
| Issuance of director's restricted stock awards   | 3,960     | —      | 175      | —        | (175 )    | —         | —         |
| Stock based compensation-restricted stock awards | —         | —      | —        | —        | 208       | —         | 208       |
| Balances at June 30, 2018                        | 2,803,126 | \$ 280 | \$43,727 | \$57,002 | \$ (983 ) | \$ (846 ) | \$ 99,180 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

**Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

| Six months ended June 30, (in thousands)                                                                                       | 2018     | 2017     |
|--------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| Operating Activities                                                                                                           |          |          |
| Net income                                                                                                                     | \$3,915  | \$3,487  |
| Adjustments to reconcile net income to net cash provided by operating activities<br>(Accretion), amortization and depreciation |          |          |
| Securities                                                                                                                     | 29       | 77       |
| Bank premises and equipment                                                                                                    | 820      | 648      |
| Core deposit intangible                                                                                                        | 236      | 253      |
| Modification fees on Federal Home Loan Bank of Boston advances                                                                 | 116      | 114      |
| Subordinated debt issuance costs                                                                                               | 12       | 11       |
| Mortgage servicing rights                                                                                                      | 23       | 136      |
| Fair value adjustment on loans                                                                                                 | (462 )   | (744 )   |
| Fair value adjustment on deposits                                                                                              | (21 )    | (47 )    |
| (Gains) and losses, including write-downs                                                                                      |          |          |
| (Gain) loss and write-downs on sales and calls of securities available-for-sale, net                                           | (16 )    | 14       |
| Loss on CRA mutual fund                                                                                                        | 20       | —        |
| Gain on sales of loans, excluding capitalized servicing rights                                                                 | (10 )    | (59 )    |
| Write-downs of other real estate owned                                                                                         | 53       | 145      |
| Loss on sale/disposals of premises and equipment                                                                               | 1        | 1        |
| Provision for loan losses                                                                                                      | 793      | 716      |
| Proceeds from loans sold                                                                                                       | 679      | 3,463    |
| Loans originated for sale                                                                                                      | (206 )   | (3,998 ) |
| (Increase) decrease in deferred loan origination fees and costs, net                                                           | (161 )   | 47       |
| Mortgage servicing rights originated                                                                                           | (7 )     | (38 )    |
| Increase in mortgage servicing rights impairment reserve                                                                       | —        | 1        |
| (Increase) decrease in interest receivable                                                                                     | (355 )   | 133      |
| Deferred tax benefit                                                                                                           | (152 )   | —        |
| Increase (decrease) in prepaid expenses                                                                                        | 129      | (104 )   |
| Increase in cash surrender value of life insurance policies                                                                    | (163 )   | (173 )   |
| Decrease in income tax receivable                                                                                              | 606      | 76       |
| (Increase) decrease in other assets                                                                                            | (17 )    | 802      |
| Increase in accrued expenses                                                                                                   | (317 )   | (996 )   |
| Increase (decrease) in interest payable                                                                                        | 123      | (2 )     |
| Increase in other liabilities                                                                                                  | (109 )   | 58       |
| Stock based compensation-restricted stock awards                                                                               | 208      | 122      |
| Net cash provided by operating activities                                                                                      | 5,767    | 4,143    |
| Investing Activities                                                                                                           |          |          |
| Purchase of Federal Home Loan Bank of Boston stock, net of redemptions                                                         | (1,175 ) | (241 )   |
| Purchases of securities available-for-sale                                                                                     | (26,248) | (25,116) |
| Proceeds from sales of securities available-for-sale                                                                           | 8,410    | —        |
| Proceeds from calls of securities available-for-sale                                                                           | 945      | 9,221    |
| Proceeds from maturities of securities available-for-sale                                                                      | 8,706    | 14,547   |
| Reinvestment of CRA mutual fund                                                                                                | (10 )    | —        |
| Loan originations and principal collections, net                                                                               | (63,442) | (2,091 ) |
| Recoveries of loans previously charged off                                                                                     | 27       | 100      |

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|                                                            |          |        |
|------------------------------------------------------------|----------|--------|
| Proceeds from sales of other real estate owned             | 188      | 177    |
| Capital expenditures                                       | (1,097 ) | (795 ) |
| Cash and cash equivalents (paid) acquired from acquisition | (298 )   | 22,375 |
| Net cash (utilized) provided by investing activities       | (73,994) | 18,177 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

**Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

| Six months ended June 30, (in thousands)                        | 2018     | 2017     |
|-----------------------------------------------------------------|----------|----------|
| Financing Activities                                            |          |          |
| Increase (decrease) in deposit transaction accounts, net        | 56,901   | (2,418 ) |
| Increase in time deposits, net                                  | 16,783   | 603      |
| Decrease in securities sold under agreements to repurchase, net | 23       | (3,409 ) |
| Federal Home Loan Bank of Boston advances                       | 52,000   | 10,000   |
| Principal payments on Federal Home Loan Bank of Boston advances | (27,000) | —        |
| Principal payments on note payable                              | (16 )    | (17 )    |
| Decrease in capital lease obligation                            | (61 )    | (11 )    |
| Stock options exercised                                         | 145      | 313      |
| Issuance of shares for directors' fees                          | —        | 81       |
| Common stock dividends paid                                     | (1,561 ) | (1,555 ) |
| Net cash provided by financing activities                       | 97,214   | 3,587    |
| Net increase in cash and cash equivalents                       | 28,987   | 25,907   |
| Cash and cash equivalents, beginning of period                  | 48,486   | 35,485   |
| Cash and cash equivalents, end of period                        | \$77,473 | \$61,392 |
| Cash paid during period                                         |          |          |
| Interest                                                        | \$2,784  | \$1,903  |
| Income taxes                                                    | 516      | 1,133    |
| Non-cash transfers                                              |          |          |
| From loans to other real estate owned                           | —        | 403      |
| Capital lease obligation                                        | 1,373    | —        |
| Adoption of ASU 2016-01                                         | 16       | —        |
| Branch Acquisitions <sup>(1)</sup>                              |          |          |
| Cash and cash equivalents (paid) acquired                       | (298 )   | 22,375   |
| Net loans acquired                                              | 7,849    | 7,097    |
| Fixed assets acquired (including capital lease in 2017)         | 761      | 1,605    |
| Accrued interest receivable acquired                            | 5        | 12       |
| Other assets acquired                                           | 6        | 20       |
| Core deposit intangible                                         | —        | 632      |
| Goodwill                                                        | —        | 1,275    |
| Deposits assumed                                                | 8,323    | 31,433   |
| Capital lease assumed                                           | —        | 1,580    |
| Other liabilities assumed                                       | —        | 3        |

<sup>(1)</sup> Branch acquisition of Empire State Bank in 2017 and Orange Bank and Trust in 2018.

The accompanying notes are an integral part of these unaudited consolidated financial statements.

**Salisbury Bancorp, Inc. and Subsidiary**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - BASIS OF PRESENTATION**

The interim (unaudited) consolidated financial statements of Salisbury Bancorp, Inc. ("Salisbury") include those of Salisbury and its wholly owned subsidiary, Salisbury Bank and Trust Company (the "Bank"). In the opinion of management, the interim unaudited consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position of Salisbury and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the interim periods presented.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of condition, and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, expected cash flows from loans acquired in a business combination, other-than-temporary impairment of securities and impairment of goodwill and intangibles.

Certain financial information, which is normally included in financial statements prepared in accordance with generally accepted accounting principles, but which is not required for interim reporting purposes, has been condensed or omitted. Operating results for the interim period ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. The accompanying condensed financial statements should be read in conjunction with the financial statements and notes thereto included in Salisbury's 2017 Annual Report on Form 10-K for the year ended December 31, 2017.

The allowance for loan losses is a significant accounting policy and is presented in the Notes to Consolidated Financial Statements and in Management's Discussion and Analysis, which provides information on how significant assets are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan losses to be the accounting area that requires the most subjective judgments, and as such could be most subject to revision as new information becomes available.

**Impact of New Accounting Pronouncements Issued**

In May 2014, August 2015, May 2016, and December 2016, respectively, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, 2015-14, 2016-12, and 2016-20, "Revenue from Contracts with Customers (Topic 606)." The objective of ASU 2014-09 is to clarify principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments, including interest income and expense. The Bank completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including trust and asset management fees, deposit related fees, interchange fees, and merchant income. Salisbury's revenue recognition policies conformed to Topic 606. As a result, no changes were required to prior period financial statements due to the adoption of this ASU and no changes in revenue recognition were required in the three and six month periods ending June 30, 2018.



In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – overall (subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. Salisbury adopted the provisions of this ASU effective January 1, 2018. Adoption of this ASU did not have a material impact on Salisbury's financial statements. In accordance with (5) above, Salisbury measured the fair value of its loan portfolio as of June 30, 2018 using an exit price notion (see note 10).

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)". Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities. ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. Salisbury does not expect ASU 2016-02 to have a material impact on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." This ASU includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Some of the key provisions of this new ASU include: (1) companies will no longer record excess tax benefits and certain tax

deficiencies in additional paid-in capital (“APIC”). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. The guidance also eliminates the requirement that excess tax benefits be realized before companies can recognize them. In addition, the guidance requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity; (2) increase the amount an employer can withhold to cover income taxes on awards and still qualify for the exception to liability classification for shares used to satisfy the employer's statutory income tax withholding obligation. The new guidance will also require an employer to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on its statement of cash flows (current guidance did not specify how these cash flows should be classified); and (3) permit companies to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. Salisbury has opted to recognize forfeitures as they occur as the impact is not expected to be material. Salisbury adopted ASU 2016-09 as of January 1, 2017. Adoption contributed a \$105 thousand benefit to the tax provision in the second quarter 2017 and did not have a material effect on the financial results for the twelve month period ended December 31, 2017.



In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” which adds a new Topic 326 to the Codification and removes the thresholds that companies apply to measure credit losses on financial instruments measured at amortized cost, such as loans, receivables, and held-to-maturity debt securities. Under current U.S. GAAP, companies generally recognize credit losses when it is probable that the loss has been incurred. The revised guidance will remove all recognition thresholds and will require companies to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the company expects to collect over the instrument's contractual life. ASU 2016-13 also amends the credit loss measurement guidance for available-for-sale debt securities and beneficial interests in securitized financial assets. The guidance in ASU 2016-13 is effective for “public business entities,” as defined, that are SEC filers for fiscal years and for interim periods with those fiscal years beginning after December 15, 2019. Early adoption is permitted as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Salisbury is currently evaluating the provisions of ASU 2016-13 to determine the potential impact the new standard will have on Salisbury's Consolidated Financial Statements.

In August 2016, the FASB issued ASU 2016-15, “Classification of Certain Cash Receipts and Cash Payments.” This ASU is intended to reduce diversity in practice in how eight particular transactions are classified in the statement of cash flows. ASU 2016-15 is effective for public business entities for fiscal years beginning after December 15, 2017 and interim periods within those years. Entities are required to apply the guidance retrospectively. If it is impracticable to apply the guidance retrospectively for an issue, the amendments related to that issue would be applied prospectively. Salisbury adopted ASU 2016-15 on January 1, 2018. ASU 2016-15 did not have a material impact on Salisbury's Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business.” This ASU is intended to add guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments in this update provide a screen to determine when a set of inputs, processes, and outputs is not a business. ASU 2017-01 is effective for public business entities for fiscal years beginning after December 15, 2017 and interim periods within those years. Early adoption is permitted for transactions for which the acquisition date occurs before the issuance date or effective date of the amendments, only when the transaction has not been reported in financial statements that have been issued or made available for issuance, or for transactions in which a subsidiary is deconsolidated or a group of assets is derecognized that occur before the issuance date or effective date of the amendments, only when the transaction has not been reported in financial statements that have been issued or made available for issuance. Entities should apply the guidance prospectively on or after the effective date. Salisbury adopted ASU 2017-01 on January 1, 2018. ASU 2017-01 did not impact Salisbury's Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-04, “Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” This ASU is intended to allow companies to simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. The FASB is researching whether similar amendments should be considered for other entities, including public business entities. ASU 2017-04 is effective for public business entities that are SEC filers for fiscal years beginning after December 15, 2019 and interim periods within those years. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Entities should apply the guidance prospectively. Salisbury is currently evaluating the provisions of ASU 2017-04 to determine the potential impact the new standard will have on Salisbury's Consolidated Financial Statements.

In March 2017, the FASB issued ASU 2017-08, “Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities.” This ASU will amend the amortization period for

certain purchased callable debt securities held at a premium. The Board is shortening the amortization period for the premium to the earliest call date. Under current generally accepted accounting principles, entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. ASU 2017-08 is effective for public business entities for annual periods beginning after December 15, 2018, including interim periods within those annual periods. Early adoption is permitted, including adoption in an interim period. Entities should apply the guidance on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Salisbury is currently evaluating the provisions of ASU 2017-08 and does not expect that the adoption of the new standard will have a material impact on Salisbury's Consolidated Financial Statements.

In May 2017, the FASB issued ASU 2017-09, "Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting." This ASU provides clarity in the accounting guidance regarding a change to the terms or conditions of a share-based payment award. ASU 2017-09 is effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Entities should apply the guidance prospectively to an award modified on or after the adoption date. Salisbury adopted ASU 2017-09 on January 1, 2018. ASU 2017-09 did not impact Salisbury's Consolidated Financial Statements.

**NOTE 2 - SECURITIES**

The composition of securities is as follows:

| (in thousands)                                                      | Amortized cost basis (1) | Gross un-realized gains | Gross un-realized losses | Fair value |
|---------------------------------------------------------------------|--------------------------|-------------------------|--------------------------|------------|
| June 30, 2018                                                       |                          |                         |                          |            |
| Available-for-sale                                                  |                          |                         |                          |            |
| U.S. Government Agency notes                                        | \$2,497                  | \$7                     | \$—                      | \$2,504    |
| Municipal bonds                                                     | 2,524                    | 5                       | —                        | 2,529      |
| Mortgage-backed securities:                                         |                          |                         |                          |            |
| U.S. Government agencies and U.S. Government- sponsored enterprises | 35,768                   | 24                      | 628                      | 35,164     |
| Collateralized mortgage obligations:                                |                          |                         |                          |            |
| U.S. Government agencies                                            | 13,803                   | 6                       | 313                      | 13,496     |
| Non-agency                                                          | 1,556                    | 371                     | 17                       | 1,910      |
| SBA bonds                                                           | 26,480                   | 32                      | 515                      | 25,997     |
| Corporate bonds                                                     | 3,500                    | 30                      | 73                       | 3,457      |
| Total securities available-for-sale                                 | \$86,128                 | \$475                   | \$1,546                  | \$85,057   |
| CRA mutual fund                                                     | \$825                    | \$—                     | \$—                      | \$825      |
| Non-marketable securities                                           |                          |                         |                          |            |
| Federal Home Loan Bank of Boston stock                              | \$4,988                  | \$—                     | \$—                      | \$4,988    |
| (in thousands)                                                      | Amortized cost basis (1) | Gross un-realized gains | Gross un-realized losses | Fair value |
| December 31, 2017                                                   |                          |                         |                          |            |
| Available-for-sale                                                  |                          |                         |                          |            |
| Municipal bonds                                                     | \$3,476                  | \$11                    | \$1                      | \$3,486    |
| Mortgage-backed securities:                                         |                          |                         |                          |            |
| U.S. Government agencies and U.S. Government- sponsored enterprises | 45,983                   | 152                     | 267                      | 45,868     |
| Collateralized mortgage obligations:                                |                          |                         |                          |            |
| U.S. Government agencies                                            | 10,462                   | 2                       | 87                       | 10,377     |
| Non-agency                                                          | 2,271                    | 410                     | 17                       | 2,664      |
| SBA bonds                                                           | 12,278                   | 9                       | 20                       | 12,267     |
| Corporate bonds                                                     | 3,500                    | 59                      | 9                        | 3,550      |
| Total securities available-for-sale                                 | \$77,970                 | \$643                   | \$401                    | \$78,212   |
| CRA mutual fund                                                     | \$835                    | \$—                     | \$—                      | \$835      |
| Non-marketable securities                                           |                          |                         |                          |            |
| Federal Home Loan Bank of Boston stock                              | \$3,813                  | \$—                     | \$—                      | \$3,813    |

(1) Net of other-than-temporary impairment write-downs recognized in earnings.

Salisbury sold \$8.4 million of available-for-sale securities during the six month period ended June 30, 2018 realizing a pre-tax gain of \$16 thousand and a related tax expense of \$3 thousand. Salisbury did not sell any available-for-sale securities during the three month period ended March 31, 2018 or the six month period ended June 30, 2017.



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|                                     |                                                                  |           |           |        |
|-------------------------------------|------------------------------------------------------------------|-----------|-----------|--------|
|                                     | Total                                                            | 2,497     | 2,504     | 3.67   |
| Municipal bonds                     | Within 1 year                                                    | 277       | 278       | 4.33   |
|                                     | After 1 year but within 5 years                                  | 259       | 259       | 3.84   |
|                                     | After 10 years but within 15 years                               | 1,988     | 1,992     | 6.13   |
|                                     | Total                                                            | 2,524     | 2,529     | 5.69   |
| Mortgage-backed securities          | U.S. Government agency and U.S. Government-sponsored enterprises | 35,768    | 35,164    | 2.36   |
| Collateralized mortgage obligations | U.S. Government agency and U.S. Government-sponsored enterprises | 13,803    | 13,496    | 3.07   |
|                                     | Non-agency                                                       | 1,556     | 1,910     | 3.53   |
| SBA bonds                           |                                                                  | 26,480    | 25,997    | 3.12   |
| Corporate bonds                     | After 5 years but within 10 years                                | 3,500     | 3,457     | 5.57   |
| Securities available-for-sale       |                                                                  | \$ 86,128 | \$ 85,057 | 3.00 % |

(1) Yield is based on amortized cost.

Salisbury evaluates securities for OTTI where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers whether it has the intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

The following summarizes, by security type, the basis for evaluating if the applicable securities were OTTI at June 30, 2018.

**U.S. Government agency mortgage-backed securities and collateralized mortgage obligations:** The contractual cash flows are guaranteed by U.S. government agencies and U.S. government-sponsored enterprises. Twenty-eight securities had unrealized losses at June 30, 2018, which approximated 2.29% of their amortized cost. Changes in fair values are a function of changes in investment spreads and interest rate movements and not changes in credit quality. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Salisbury evaluates these securities for strategic fit and may reduce its position in these securities, although it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity, and does not intend to sell these securities. Therefore, management does not consider these investments to be other-than-temporarily impaired at June 30, 2018.

**SBA bonds:** The contractual cash flows are guaranteed by the U.S. government. Fourteen securities had unrealized losses at June 30, 2018, which approximated 2.36% of their amortized cost. Changes in fair values are a function of changes in investment spreads and interest rate movements and not changes in credit quality since time of purchase. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Salisbury evaluates these securities for strategic fit and may reduce its position in these securities, although it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity, and does not intend to sell these securities. Management evaluated the impairment status of these debt securities, and concluded that the gross unrealized losses were temporary in nature. Therefore, management does not consider these investments to be other-than temporarily impaired at June 30, 2018.

**Corporate bonds:** Salisbury regularly monitors and analyzes its corporate bond portfolio for credit quality. Three securities had unrealized losses at June 30, 2018, which approximated 3.65% of their amortized cost. Management believes the unrealized loss position is attributable to interest rate and spread movements and not changes in credit quality. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Salisbury evaluates these securities for strategic fit and may reduce its position in these securities, although it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity, and does not intend to sell these securities. Management evaluated the impairment status of these debt securities, and concluded that the gross unrealized losses were temporary in nature. Therefore management does not consider these investments to be other-than temporarily impaired at June 30, 2018.

**Non-agency CMOs:** Salisbury performed a detailed cash flow analysis of its non-agency CMOs at June 30, 2018, to assess whether any of the securities were OTTI. Two security had unrealized losses at June 30, 2018, which approximated 14.38% of its amortized cost. Salisbury uses cash flow forecasts for each security based on a variety of market driven assumptions and securitization terms, including prepayment speed, default or delinquency rate, and default severity for losses including interest, legal fees, property repairs, expenses and realtor fees, that, together with the loan amount are subtracted from collateral sales proceeds to determine severity. In 2009, Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of \$1,128,000. Salisbury judged the other non-agency CMO securities not to have additional OTTI and all other CMO securities not to be OTTI as of June 30, 2018. It is possible that future loss assumptions could change necessitating

Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury evaluates these securities for strategic fit and depending upon such factor could reduce its position in these securities, although it has no present intention to do so, and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis.

The following table presents activity related to credit losses recognized into earnings on the non-agency CMOs held by Salisbury for which a portion of an OTTI charge was recognized in accumulated other comprehensive income:

| Six months ended June 30 (in thousands)                                         | 2018    | 2017    |
|---------------------------------------------------------------------------------|---------|---------|
| Balance, beginning of period                                                    | \$1,128 | \$1,128 |
| Credit component on debt securities in which OTTI was not previously recognized | —       | —       |
| Balance, end of period                                                          | \$1,128 | \$1,128 |

The Federal Home Loan Bank of Boston (FHLBB) is a cooperative that provides services, including funding in the form of advances, to its member banking institutions. As a requirement of membership, the Bank must own a minimum amount of FHLBB stock, calculated periodically based primarily on its level of borrowings from the FHLBB. No market exists for shares of the FHLBB and therefore, they are carried at par value. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Board, to maintain capital adequacy of the FHLBB. While the Bank currently has no intentions to terminate its FHLBB membership, the ability to redeem its investment in FHLBB stock would be subject to the conditions imposed by the FHLBB. Based on the capital adequacy and the liquidity position of the FHLBB, management believes there is no impairment related to the carrying amount of the Bank's FHLBB stock as of June 30, 2018. Deterioration of the FHLBB's capital levels may require the Bank to deem its restricted investment in FHLBB stock to be OTTI. If evidence of impairment exists in the future, the FHLBB stock would reflect fair value using either observable or unobservable inputs. The Bank will continue to monitor its investment in FHLBB stock.

**NOTE 3 – LOANS**

The composition of loans receivable and loans held-for-sale is as follows:

| (In thousands)                                | June 30, 2018 | December 31, 2017 |
|-----------------------------------------------|---------------|-------------------|
|                                               | Total Loans   | Total Loans       |
| Residential 1-4 family                        | \$335,383     | \$317,639         |
| Residential 5+ multifamily                    | 25,775        | 18,108            |
| Construction of residential 1-4 family        | 12,035        | 11,197            |
| Home equity lines of credit                   | 33,930        | 33,771            |
| Residential real estate                       | 407,123       | 380,715           |
| Commercial                                    | 272,395       | 249,311           |
| Construction of commercial                    | 11,544        | 9,988             |
| Commercial real estate                        | 283,939       | 259,299           |
| Farm land                                     | 4,432         | 4,274             |
| Vacant land                                   | 8,847         | 7,883             |
| Real estate secured                           | 704,341       | 652,171           |
| Commercial and industrial                     | 150,911       | 132,731           |
| Municipal                                     | 18,608        | 17,494            |
| Consumer                                      | 4,867         | 4,794             |
| Loans receivable, gross                       | 878,727       | 807,190           |
| Deferred loan origination fees and costs, net | 1,450         | 1,289             |
| Allowance for loan losses                     | (7,381)       | (6,776)           |
| Loans receivable, net                         | \$872,796     | \$801,703         |
| Loans held-for-sale                           |               |                   |
| Residential 1-4 family                        | \$206         | \$669             |

**Concentrations of Credit Risk**

Salisbury's loans consist primarily of residential and commercial real estate loans located principally in Litchfield County, Connecticut, Dutchess, Ulster and Orange Counties, New York and Berkshire County, Massachusetts, which constitute Salisbury's service area. Salisbury offers a broad range of loan and credit facilities to borrowers in its service area, including residential mortgage loans, commercial real estate loans, construction loans, working capital loans, equipment loans, and a variety of consumer loans, including home equity lines of credit, installment loans and collateral loans. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability of single family residential and consumer borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the market area and real estate values. The ability of commercial borrowers to honor their repayment commitments is dependent on the general economy as well as the health of the real estate economic sector in Salisbury's market area.

**Credit Quality**

Salisbury uses credit risk ratings as part of its determination of the allowance for loan losses. Credit risk ratings categorize loans by common financial and structural characteristics that measure the credit strength of a borrower. The rating model has eight risk rating grades, with each grade corresponding to a progressively greater risk of default. Grades 1 through 4 are pass ratings and 5 through 8 are criticized as defined by the regulatory agencies. Risk ratings are assigned to differentiate risk within the portfolio and are reviewed on an ongoing basis and revised, if needed, to reflect changes in the borrowers' current financial position and outlook, risk profiles and the related collateral and structural positions.



Loans rated as "special mention" possess credit deficiencies or potential weaknesses deserving management's close attention that if left uncorrected may result in deterioration of the repayment prospects for the loans at some future date.

Loans rated as "substandard" are loans where the Bank's position is clearly not protected adequately by borrower current net worth or payment capacity. These loans have well defined weaknesses based on objective evidence and include loans where future losses to the Bank may result if deficiencies are not corrected, and loans where the primary source of repayment such as income is diminished and the Bank must rely on sale of collateral or other secondary sources of collection.

Loans rated "doubtful" have the same weaknesses as substandard loans with the added characteristic that the weakness makes collection or liquidation in full, given current facts, conditions, and values, to be highly improbable. The possibility of loss is high, but due to certain important and reasonably specific pending factors, which may work to strengthen the loan, its reclassification as an estimated loss is deferred until its exact status can be determined.

Loans classified as "loss" are considered uncollectible and of such little value that continuance as Bank assets is unwarranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this loan even though partial recovery may be made in the future.

Management actively reviews and tests its credit risk ratings against actual experience and engages an independent third-party to annually validate its assignment of credit risk ratings. In addition, the Bank's loan portfolio is examined periodically by its regulatory agencies, the FDIC and the Connecticut Department of Banking.

The composition of loans receivable by risk rating grade is as follows:

| (in thousands)                         | Pass      | Special<br>mention | Substandard | Doubtful | Loss | Total     |
|----------------------------------------|-----------|--------------------|-------------|----------|------|-----------|
| June 30, 2018                          |           |                    |             |          |      |           |
| Residential 1-4 family                 | \$324,483 | \$6,049            | \$ 4,851    | \$ —     | \$ — | \$335,383 |
| Residential 5+ multifamily             | 23,595    | 1,172              | 1,008       | —        | —    | 25,775    |
| Construction of residential 1-4 family | 12,035    | —                  | —           | —        | —    | 12,035    |
| Home equity lines of credit            | 33,086    | 325                | 519         | —        | —    | 33,930    |
| Residential real estate                | 393,199   | 7,546              | 6,378       | —        | —    | 407,123   |
| Commercial                             | 258,580   | 3,272              | 10,543      | —        | —    | 272,395   |
| Construction of commercial             | 11,182    | —                  | 362         | —        | —    | 11,544    |
| Commercial real estate                 | 269,762   | 3,272              | 10,905      | —        | —    | 283,939   |
| Farm land                              | 4,202     | —                  | 230         | —        | —    | 4,432     |
| Vacant land                            | 8,774     | 73                 | —           | —        | —    | 8,847     |
| Real estate secured                    | 675,937   | 10,891             | 17,513      | —        | —    | 704,341   |
| Commercial and industrial              | 148,309   | 1,710              | 892         | —        | —    | 150,911   |
| Municipal                              | 18,608    | —                  | —           | —        | —    | 18,608    |
| Consumer                               | 4,839     | 28                 | —           | —        | —    | 4,867     |
| Loans receivable, gross                | \$847,693 | \$12,629           | \$ 18,405   | \$ —     | \$ — | \$878,727 |
| (in thousands)                         | Pass      | Special<br>mention | Substandard | Doubtful | Loss | Total     |
| December 31, 2017                      |           |                    |             |          |      |           |
| Residential 1-4 family                 | \$307,240 | \$6,452            | \$ 3,947    | \$ —     | \$ — | \$317,639 |
| Residential 5+ multifamily             | 16,129    | 957                | 1,022       | —        | —    | 18,108    |
| Construction of residential 1-4 family | 11,197    | —                  | —           | —        | —    | 11,197    |
| Home equity lines of credit            | 32,891    | 710                | 170         | —        | —    | 33,771    |
| Residential real estate                | 367,457   | 8,119              | 5,139       | —        | —    | 380,715   |
| Commercial                             | 232,492   | 4,456              | 12,363      | —        | —    | 249,311   |
| Construction of commercial             | 9,622     | —                  | 366         | —        | —    | 9,988     |
| Commercial real estate                 | 242,114   | 4,456              | 12,729      | —        | —    | 259,299   |
| Farm land                              | 4,024     | —                  | 250         | —        | —    | 4,274     |
| Vacant land                            | 7,806     | 77                 | —           | —        | —    | 7,883     |
| Real estate secured                    | 621,401   | 12,652             | 18,118      | —        | —    | 652,171   |
| Commercial and industrial              | 129,219   | 2,536              | 976         | —        | —    | 132,731   |
| Municipal                              | 17,494    | —                  | —           | —        | —    | 17,494    |
| Consumer                               | 4,744     | 50                 | —           | —        | —    | 4,794     |
| Loans receivable, gross                | \$772,858 | \$15,238           | \$ 19,094   | \$ —     | \$ — | \$807,190 |

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The composition of loans receivable by delinquency status is as follows:

| (in thousands)                         | Past due  |            |            |             |                   |                  |                           |             |
|----------------------------------------|-----------|------------|------------|-------------|-------------------|------------------|---------------------------|-------------|
|                                        | Current   | 30-59 days | 60-89 days | 90-179 days | 180 days and over | 30 days and over | Accruing 90 days and over | Non-accrual |
| June 30, 2018                          |           |            |            |             |                   |                  |                           |             |
| Residential 1-4 family                 | \$333,436 | \$370      | \$33       | \$527       | \$1,017           | \$1,947          | \$ —                      | \$2,052     |
| Residential 5+ multifamily             | 25,546    | 229        | —          | —           | —                 | 229              | —                         | 145         |
| Construction of residential 1-4 family | 12,035    | —          | —          | —           | —                 | —                | —                         | —           |
| Home equity lines of credit            | 33,493    | 78         | —          | 359         | —                 | 437              | 359                       | 60          |
| Residential real estate                | 404,510   | 677        | 33         | 886         | 1,017             | 2,613            | 359                       | 2,257       |
| Commercial                             | 269,513   | —          | 465        | 776         | 1,641             | 2,882            | —                         | 2,418       |
| Construction of commercial             | 11,287    | —          | —          | —           | 257               | 257              | —                         | 257         |
| Commercial real estate                 | 280,800   | —          | 465        | 776         | 1,898             | 3,139            | —                         | 2,675       |
| Farm land                              | 4,432     | —          | —          | —           | —                 | —                | —                         | 230         |
| Vacant land                            | 8,847     | —          | —          | —           | —                 | —                | —                         | —           |
| Real estate secured                    | 698,589   | 677        | 498        | 1,662       | 2,915             | 5,752            | 359                       | 5,162       |
| Commercial and industrial              | 150,198   | 314        | 39         | —           | 360               | 713              | —                         | 360         |
| Municipal                              | 18,608    | —          | —          | —           | —                 | —                | —                         | —           |
| Consumer                               | 4,849     | 16         | 2          | —           | —                 | 18               | —                         | —           |
| Loans receivable, gross                | \$872,244 | \$1,007    | \$539      | \$1,662     | \$3,275           | \$6,483          | \$ 359                    | \$5,522     |

| (in thousands)                         | Past due  |            |            |             |                   |                  |                           |             |
|----------------------------------------|-----------|------------|------------|-------------|-------------------|------------------|---------------------------|-------------|
|                                        | Current   | 30-59 days | 60-89 days | 90-179 days | 180 days and over | 30 days and over | Accruing 90 days and over | Non-accrual |
| December 31, 2017                      |           |            |            |             |                   |                  |                           |             |
| Residential 1-4 family                 | \$314,798 | \$1,410    | \$165      | \$156       | \$1,110           | \$2,841          | \$ —                      | \$2,045     |
| Residential 5+ multifamily             | 18,108    | —          | —          | —           | —                 | —                | —                         | 151         |
| Construction of residential 1-4 family | 11,197    | —          | —          | —           | —                 | —                | —                         | —           |
| Home equity lines of credit            | 33,219    | 75         | 477        | —           | —                 | 552              | —                         | 66          |
| Residential real estate                | 377,322   | 1,485      | 642        | 156         | 1,110             | 3,393            | —                         | 2,262       |
| Commercial                             | 244,869   | 1,888      | 758        | —           | 1,796             | 4,442            | —                         | 3,364       |
| Construction of commercial             | 9,730     | —          | —          | —           | 258               | 258              | —                         | 258         |
| Commercial real estate                 | 254,599   | 1,888      | 758        | —           | 2,054             | 4,700            | —                         | 3,622       |
| Farm land                              | 4,032     | 242        | —          | —           | —                 | 242              | —                         | 250         |
| Vacant land                            | 7,883     | —          | —          | —           | —                 | —                | —                         | —           |
| Real estate secured                    | 643,836   | 3,615      | 1,400      | 156         | 3,164             | 8,335            | —                         | 6,134       |
| Commercial and industrial              | 131,991   | 131        | 218        | 391         | —                 | 740              | 31                        | 470         |
| Municipal                              | 17,494    | —          | —          | —           | —                 | —                | —                         | —           |
| Consumer                               | 4,752     | 34         | 8          | —           | —                 | 42               | —                         | —           |
| Loans receivable, gross                | \$798,073 | \$3,780    | \$1,626    | \$547       | \$3,164           | \$9,117          | \$ 31                     | \$6,604     |

One CRE loan of \$686 thousand was modified in troubled debt restructurings for a rate reduction in the second quarter of 2018. One CRE loan of \$600 thousand modified in troubled debt restructurings for term extension and amortization in the second quarter 2017.

**Allowance for Loan Losses**

Changes in the allowance for loan losses are as follows:

| (in thousands)                         | Three months ended June 30, 2018 |           |             |            |                | Three months ended June 30, 2017 |           |             |            |                |
|----------------------------------------|----------------------------------|-----------|-------------|------------|----------------|----------------------------------|-----------|-------------|------------|----------------|
|                                        | Beginning balance                | Provision | Charge-offs | Recoveries | Ending balance | Beginning balance                | Provision | Charge-offs | Recoveries | Ending balance |
| Residential 1-4 family                 | \$1,982                          | \$ 24     | \$—         | \$ 1       | \$2,007        | \$1,990                          | \$ (38 )  | \$(37 )     | \$ 2       | \$1,917        |
| Residential 5+ multifamily             | 216                              | 42        | —           | —          | 258            | 84                               | 32        | —           | —          | 116            |
| Construction of residential 1-4 family | 74                               | 8         | —           | —          | 82             | 77                               | (6 )      | —           | —          | 71             |
| Home equity lines of credit            | 233                              | 1         | —           | —          | 234            | 330                              | (81 )     | —           | —          | 249            |
| Residential real estate                | 2,505                            | 75        | —           | 1          | 2,581          | 2,481                            | (93 )     | (37 )       | 2          | 2,353          |
| Commercial                             | 2,666                            | 259       | (149 )      | —          | 2,776          | 1,989                            | 348       | —           | 1          | 2,338          |
| Construction of commercial             | 93                               | 9         | —           | —          | 102            | 33                               | 13        | —           | —          | 46             |
| Commercial real estate                 | 2,759                            | 268       | (149 )      | —          | 2,878          | 2,022                            | 361       | —           | 1          | 2,384          |
| Farm land                              | 33                               | 4         | —           | —          | 37             | 39                               | (16 )     | —           | —          | 23             |
| Vacant land                            | 131                              | 3         | —           | —          | 134            | 150                              | (19 )     | —           | —          | 131            |
| Real estate secured                    | 5,428                            | 350       | (149 )      | 1          | 5,630          | 4,692                            | 233       | (37 )       | 3          | 4,891          |
| Commercial and industrial              | 938                              | 201       | —           | 5          | 1,144          | 916                              | 193       | (120 )      | 12         | 1,001          |
| Municipal                              | 30                               | (1 )      | —           | —          | 29             | 54                               | (36 )     | —           | —          | 18             |
| Consumer                               | 61                               | 3         | (6 )        | 5          | 63             | 93                               | (10 )     | (15 )       | 1          | 69             |
| Unallocated                            | 601                              | (86 )     | —           | —          | 515            | 530                              | (16 )     | —           | —          | 514            |
| Totals                                 | \$7,058                          | \$ 467    | \$(155 )    | \$ 11      | \$7,381        | \$6,285                          | \$ 364    | \$(172 )    | \$ 16      | \$6,493        |

| (in thousands)                         | Six months ended June 30, 2018 |           |             |            |                | Six months ended June 30, 2017 |           |             |            |                |
|----------------------------------------|--------------------------------|-----------|-------------|------------|----------------|--------------------------------|-----------|-------------|------------|----------------|
|                                        | Beginning balance              | Provision | Charge-offs | Recoveries | Ending balance | Beginning balance              | Provision | Charge-offs | Recoveries | Ending balance |
| Residential 1-4 family                 | \$1,862                        | \$ 154    | \$(10 )     | \$ 1       | \$2,007        | \$1,925                        | \$ 69     | \$(80 )     | \$ 3       | \$1,917        |
| Residential 5+ multifamily             | 155                            | 103       | —           | —          | 258            | 62                             | 54        | —           | —          | 116            |
| Construction of residential 1-4 family | 75                             | 7         | —           | —          | 82             | 91                             | (20 )     | —           | —          | 71             |
| Home equity lines of credit            | 236                            | (3 )      | —           | 1          | 234            | 348                            | (100 )    | —           | 1          | 249            |
| Residential real estate                | 2,328                          | 261       | (10 )       | 2          | 2,581          | 2,426                          | 3         | (80 )       | 4          | 2,353          |
| Commercial                             | 2,547                          | 377       | (149 )      | 1          | 2,776          | 1,919                          | 578       | (188 )      | 29         | 2,338          |
| Construction of commercial             | 80                             | 22        | —           | —          | 102            | 38                             | 8         | —           | —          | 46             |
| Commercial real estate                 | 2,627                          | 399       | (149 )      | 1          | 2,878          | 1,957                          | 586       | (188 )      | 29         | 2,384          |
| Farm land                              | 32                             | 5         | —           | —          | 37             | 28                             | 10        | (15 )       | —          | 23             |
| Vacant land                            | 131                            | 3         | —           | —          | 134            | 170                            | (39 )     | —           | —          | 131            |
| Real estate secured                    | 5,118                          | 668       | (159 )      | 3          | 5,630          | 4,581                          | 560       | (283 )      | 33         | 4,891          |
| Commercial and industrial              | 984                            | 159       | (10 )       | 11         | 1,144          | 1,080                          | (16 )     | (121 )      | 58         | 1,001          |
| Municipal                              | 30                             | (1 )      | —           | —          | 29             | 53                             | (35 )     | —           | —          | 18             |
| Consumer                               | 81                             | 14        | (45 )       | 13         | 63             | 76                             | 30        | (46 )       | 9          | 69             |
| Unallocated                            | 563                            | (48 )     | —           | —          | 515            | 337                            | 177       | —           | —          | 514            |
| Totals                                 | \$6,776                        | \$ 792    | \$(214 )    | \$ 27      | \$7,381        | \$6,127                        | \$ 716    | \$(450 )    | \$ 100     | \$6,493        |



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The composition of loans receivable and the allowance for loan losses is as follows:

| (in thousands)                         | Collectively evaluated <sup>1</sup> |           | Individually evaluated |           | Total portfolio |           |
|----------------------------------------|-------------------------------------|-----------|------------------------|-----------|-----------------|-----------|
|                                        | Loans                               | Allowance | Loans                  | Allowance | Loans           | Allowance |
| June 30, 2018                          |                                     |           |                        |           |                 |           |
| Residential 1-4 family                 | \$329,834                           | \$1,890   | \$5,549                | \$117     | \$335,383       | \$2,007   |
| Residential 5+ multifamily             | 24,092                              | 258       | 1,683                  | —         | 25,775          | 258       |
| Construction of residential 1-4 family | 12,035                              | 82        | —                      | —         | 12,035          | 82        |
| Home equity lines of credit            | 33,823                              | 232       | 107                    | 2         | 33,930          | 234       |
| Residential real estate                | 399,784                             | 2,462     | 7,339                  | 119       | 407,123         | 2,581     |
| Commercial                             | 267,118                             | 2,633     | 5,277                  | 143       | 272,395         | 2,776     |
| Construction of commercial             | 11,182                              | 102       | 362                    | —         | 11,544          | 102       |
| Commercial real estate                 | 278,300                             | 2,735     | 5,639                  | 143       | 283,939         | 2,878     |
| Farm land                              | 4,202                               | 37        | 230                    | —         | 4,432           | 37        |
| Vacant land                            | 8,653                               | 131       | 194                    | 3         | 8,847           | 134       |
| Real estate secured                    | 690,939                             | 5,365     | 13,402                 | 265       | 704,341         | 5,630     |
| Commercial and industrial              | 150,403                             | 1,144     | 508                    | —         | 150,911         | 1,144     |
| Municipal                              | 18,608                              | 29        | —                      | —         | 18,608          | 29        |
| Consumer                               | 4,867                               | 63        | —                      | —         | 4,867           | 63        |
| Unallocated allowance                  | —                                   | 515       | —                      | —         | —               | 515       |
| Totals                                 | \$864,817                           | \$7,116   | \$13,910               | \$265     | \$878,727       | \$7,381   |

| (in thousands)                         | Collectively evaluated <sup>1</sup> |           | Individually evaluated |           | Total portfolio |           |
|----------------------------------------|-------------------------------------|-----------|------------------------|-----------|-----------------|-----------|
|                                        | Loans                               | Allowance | Loans                  | Allowance | Loans           | Allowance |
| December 31, 2017                      |                                     |           |                        |           |                 |           |
| Residential 1-4 family                 | \$312,456                           | \$1,759   | \$5,183                | \$103     | \$317,639       | \$1,862   |
| Residential 5+ multifamily             | 16,361                              | 154       | 1,747                  | 1         | 18,108          | 155       |
| Construction of residential 1-4 family | 11,197                              | 75        | —                      | —         | 11,197          | 75        |
| Home equity lines of credit            | 33,658                              | 235       | 113                    | 1         | 33,771          | 236       |
| Residential real estate                | 373,672                             | 2,223     | 7,043                  | 105       | 380,715         | 2,328     |
| Commercial                             | 243,602                             | 2,432     | 5,709                  | 115       | 249,311         | 2,547     |
| Construction of commercial             | 9,622                               | 80        | 366                    | —         | 9,988           | 80        |
| Commercial real estate                 | 253,224                             | 2,512     | 6,075                  | 115       | 259,299         | 2,627     |
| Farm land                              | 4,024                               | 32        | 250                    | —         | 4,274           | 32        |
| Vacant land                            | 7,684                               | 129       | 199                    | 3         | 7,883           | 132       |
| Real estate secured                    | 638,604                             | 4,896     | 13,567                 | 223       | 652,171         | 5,119     |
| Commercial and industrial              | 132,212                             | 952       | 519                    | 32        | 132,731         | 984       |
| Municipal                              | 17,494                              | 30        | —                      | —         | 17,494          | 30        |
| Consumer                               | 4,794                               | 80        | —                      | —         | 4,794           | 80        |
| Unallocated allowance                  | —                                   | 563       | —                      | —         | —               | 563       |
| Totals                                 | \$793,104                           | \$6,521   | \$14,086               | \$255     | \$807,190       | \$6,776   |

<sup>1</sup> Includes amounts reflecting ASC 310-30 accounting for purchased loans with deteriorated credit quality with respect to deterioration in credit quality that occurs subsequent to origination and which makes it probable that the Company will be unable to collect all contractually required payments from the borrower. ASC 310-30 loans and allowance were \$1.8 million and \$0, respectively for June 30, 2018 and \$2.4 million and \$92,000, respectively for December 31, 2017.





The credit quality segments of loans receivable and the allowance for loan losses are as follows:

| June 30, 2018 (in thousands)         | Collectively evaluated |           | Individually evaluated |           | Total portfolio |           |
|--------------------------------------|------------------------|-----------|------------------------|-----------|-----------------|-----------|
|                                      | Loans                  | Allowance | Loans                  | Allowance | Loans           | Allowance |
| Performing loans                     | \$855,379              | \$6,426   | \$—                    | \$—       | \$855,379       | \$ 6,426  |
| Potential problem loans <sup>1</sup> | 9,438                  | 175       | —                      | —         | 9,438           | 175       |
| Impaired loans                       | —                      | —         | 13,910                 | 265       | 13,910          | 265       |
| Unallocated allowance                | —                      | 515       | —                      | —         | —               | 515       |
| Totals                               | \$864,817              | \$7,116   | \$13,910               | \$265     | \$878,727       | \$ 7,381  |

| December 31, 2017 (in thousands)     | Collectively evaluated |           | Individually evaluated |           | Total portfolio |           |
|--------------------------------------|------------------------|-----------|------------------------|-----------|-----------------|-----------|
|                                      | Loans                  | Allowance | Loans                  | Allowance | Loans           | Allowance |
| Performing loans                     | \$783,206              | \$5,619   | \$—                    | \$—       | \$783,206       | \$ 5,619  |
| Potential problem loans <sup>1</sup> | 9,898                  | 339       | —                      | —         | 9,898           | 339       |
| Impaired loans                       | —                      | —         | 14,086                 | 255       | 14,086          | 255       |
| Unallocated allowance                | —                      | 563       | —                      | —         | —               | 563       |
| Totals                               | \$793,104              | \$6,521   | \$14,086               | \$255     | \$807,190       | \$ 6,776  |

<sup>1</sup> Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and are not classified as impaired.

A specific valuation allowance is established for the impairment amount of each impaired loan, calculated using the present value of expected cash flows or fair value of collateral, in accordance with the most likely means of recovery. Certain data with respect to loans individually evaluated for impairment is as follows:

| (in thousands)              | Impaired loans with specific allowance |         |         |                    |                   | Impaired loans with no specific allowance |          |         |                   |
|-----------------------------|----------------------------------------|---------|---------|--------------------|-------------------|-------------------------------------------|----------|---------|-------------------|
|                             | Loan balance                           |         |         | Specific allowance | Income recognized | Loan balance                              |          |         | Income recognized |
|                             | Book                                   | Note    | Average |                    |                   | Book                                      | Note     | Average |                   |
| June 30, 2018               |                                        |         |         |                    |                   |                                           |          |         |                   |
| Residential                 | \$3,331                                | \$3,382 | \$3,965 | \$117              | \$57              | \$3,901                                   | \$4,936  | \$2,976 | \$63              |
| Home equity lines of credit | 47                                     | 47      | 47      | 2                  | 1                 | 60                                        | 113      | 63      | —                 |
| Residential real estate     | 3,378                                  | 3,429   | 4,012   | 119                | 58                | 3,961                                     | 5,049    | 3,039   | 63                |
| Commercial                  | 1,818                                  | 1,843   | 2,026   | 143                | 30                | 3,459                                     | 4,941    | 3,027   | 43                |
| Construction of commercial  | —                                      | —       | 15      | —                  | —                 | 362                                       | 386      | 348     | 3                 |
| Farm land                   | —                                      | —       | —       | —                  | —                 | 230                                       | 443      | 240     | —                 |
| Vacant land                 | 43                                     | 43      | 44      | 3                  | 1                 | 151                                       | 173      | 153     | 5                 |
| Real estate secured         | 5,239                                  | 5,315   | 6,097   | 265                | 89                | 8,163                                     | 10,992   | 6,807   | 114               |
| Commercial and industrial   | —                                      | —       | 74      | —                  | —                 | 508                                       | 607      | 439     | 1                 |
| Consumer                    | —                                      | —       | —       | —                  | —                 | —                                         | 4        | —       | —                 |
| Totals                      | \$5,239                                | \$5,315 | \$6,171 | \$265              | \$89              | \$8,671                                   | \$11,603 | \$7,246 | \$115             |



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| (in thousands)              | Impaired loans with specific allowance |         |         |                    |                   | Impaired loans with no specific allowance |          |         |                   |
|-----------------------------|----------------------------------------|---------|---------|--------------------|-------------------|-------------------------------------------|----------|---------|-------------------|
|                             | Loan balance                           |         | Average | Specific allowance | Income recognized | Loan balance                              |          | Average | Income recognized |
| Book                        | Note                                   | Book    |         |                    |                   | Note                                      |          |         |                   |
| June 30, 2017               |                                        |         |         |                    |                   |                                           |          |         |                   |
| Residential                 | \$3,395                                | \$3,501 | \$3,451 | \$137              | \$53              | \$3,460                                   | \$4,198  | \$3,597 | \$57              |
| Home equity lines of credit | 47                                     | 49      | 99      | 1                  | 1                 | 135                                       | 186      | 183     | 10                |
| Residential real estate     | 3,442                                  | 3,550   | 3,550   | 138                | 54                | 3,595                                     | 4,384    | 3,780   | 67                |
| Commercial                  | 2,404                                  | 2,798   | 3,212   | 250                | 37                | 3,764                                     | 4,855    | 3,251   | 65                |
| Construction of commercial  | 112                                    | 118     | 16      | —                  | 4                 | 258                                       | 272      | 355     | —                 |
| Farm land                   | —                                      | —       | —       | —                  | —                 | 986                                       | 1,151    | 982     | —                 |
| Vacant land                 | 45                                     | 45      | 45      | 3                  | 1                 | 159                                       | 184      | 162     | 6                 |
| Real estate secured         | 6,003                                  | 6,511   | 6,823   | 391                | 96                | 8,762                                     | 10,846   | 8,530   | 138               |
| Commercial and industrial   | 110                                    | 110     | 16      | 32                 | —                 | 79                                        | 112      | 124     | 4                 |
| Consumer                    | —                                      | —       | —       | —                  | —                 | —                                         | 7        | 2       | —                 |
| Totals                      | \$6,113                                | \$6,621 | \$6,839 | \$423              | \$96              | \$8,841                                   | \$10,965 | \$8,656 | \$142             |

**NOTE 4 - MORTGAGE SERVICING RIGHTS**

| (in thousands)                                 | June 30, 2018 | December 31, 2017 |
|------------------------------------------------|---------------|-------------------|
| Residential mortgage loans serviced for others | \$113,773     | \$117,538         |
| Fair value of mortgage servicing rights        | 1,044         | 1,010             |

Changes in mortgage servicing rights are as follows:

| Periods ended June 30, (in thousands)         | Three months ended |         | Six months ended |         |
|-----------------------------------------------|--------------------|---------|------------------|---------|
|                                               | 2018               | 2017    | 2018             | 2017    |
| Mortgage Servicing Rights                     |                    |         |                  |         |
| Balance, beginning of period                  | \$228              | \$296   | \$233            | \$339   |
| Originated                                    | —                  | 14      | 7                | 38      |
| Amortization (1)                              | (11 )              | (69 )   | (23 )            | (136 )  |
| Balance, end of period                        | \$217              | \$241   | \$217            | \$241   |
| Valuation Allowance                           |                    |         |                  |         |
| Balance, beginning of period                  | \$—                | \$(25 ) | \$—              | \$(23 ) |
| Decrease (increase) in impairment reserve (1) | —                  | 1       | —                | (1 )    |
| Balance, end of period                        | —                  | (24 )   | —                | (24 )   |
| Mortgage servicing rights, net                | \$217              | \$217   | \$217            | \$217   |

(1) Amortization expense and changes in the impairment reserve are recorded in mortgage servicing, net.

**NOTE 5 - PLEDGED ASSETS**

| (in thousands)                                | June 30, 2018 | December 31, 2017 |
|-----------------------------------------------|---------------|-------------------|
| Securities available-for-sale (at fair value) | \$70,881      | \$67,377          |

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|                                  |           |           |
|----------------------------------|-----------|-----------|
| Loans receivable (at book value) | 219,286   | 204,354   |
| Total pledged assets             | \$290,167 | \$271,731 |

At June 30, 2018, securities were pledged as follows: \$66.7 million to secure public deposits, \$4.2 million to secure repurchase agreements and \$0.1 million to secure FHLBB advances. In addition to securities, loans receivable were pledged to secure FHLBB advances and credit facilities.

**NOTE 6 – EARNINGS PER SHARE**

Salisbury defines unvested share-based payment awards that contain non-forfeitable rights to dividends as participating securities that are included in computing earnings per share (EPS) using the two-class method.

The two-class method is an earnings allocation formula that determines earnings per share for each share of common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to common shares and participating securities based on their respective rights to receive dividends. Basic EPS excludes dilution and is computed by dividing income allocated to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

The following table sets forth the computation of earnings per share (basic and diluted) for the periods indicated:

|                                                                                                | Three months<br>ended |         | Six months<br>ended |         |
|------------------------------------------------------------------------------------------------|-----------------------|---------|---------------------|---------|
| Periods ended June 30, (in thousands, except per share data)                                   | 2018                  | 2017    | 2018                | 2017    |
| Net income                                                                                     | \$1,899               | \$1,882 | \$3,915             | \$3,487 |
| Less: Undistributed earnings allocated to participating securities                             | (22 )                 | (15 )   | (42 )               | (26 )   |
| Net income allocated to common stock                                                           | \$1,877               | \$1,867 | \$3,873             | \$3,461 |
| Weighted average common shares issued                                                          | 2,794                 | 2,780   | 2,790               | 2,773   |
| Less: Unvested restricted stock awards                                                         | (32 )                 | (23 )   | (30 )               | (20 )   |
| Weighted average common shares outstanding used to calculate basic earnings per common share   | 2,762                 | 2,757   | 2,760               | 2,753   |
| Add: Dilutive effect of unvested restricted stock awards                                       | 17                    | 18      | 20                  | 19      |
| Weighted average common shares outstanding used to calculate diluted earnings per common share | 2,779                 | 2,775   | 2,780               | 2,772   |
| Earnings per common share (basic)                                                              | \$0.68                | \$0.68  | \$1.40              | \$1.26  |
| Earnings per common share (diluted)                                                            | \$0.68                | \$0.67  | \$1.39              | \$1.25  |

**NOTE 7 – SHAREHOLDERS' EQUITY****Capital Requirements**

Salisbury and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional and discretionary actions by the regulators that, if undertaken, could have a direct material effect on Salisbury's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Salisbury and the Bank must meet specific guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Salisbury and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

In July 2013, the Federal Reserve Bank (FRB) approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for bank holding companies and their bank subsidiaries. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. On April 8, 2014, the FDIC adopted as final its interim final rule, which is identical in substance to the final rules issued by the FRB in July 2013. Under the final rules, minimum requirements increased for both the

quantity and quality of capital held by the Bank and Company. The rules include a common equity Tier 1 capital risk-weighted assets minimum ratio of 4.5%, minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%, require a minimum ratio of Total capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. The initial implementation of the capital conservation buffer began phasing in January 1, 2016 at 0.625% of risk-weighted assets and increases each subsequent January 1, by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. As of June 30, 2018, the Bank exceeded the fully phased in regulatory requirement for the capital conservation buffer. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules.

Actual regulatory capital position and minimum capital requirements as defined "To Be Well Capitalized Under Prompt Corrective Action Provisions" and "For Capital Adequacy Purposes" for Salisbury and the Bank are as follows:

| (dollars in thousands)                                 | Actual     |        | To be Well Capitalized<br>For Capital Adequacy Purposes |       |                                           |       |
|--------------------------------------------------------|------------|--------|---------------------------------------------------------|-------|-------------------------------------------|-------|
|                                                        | Amount     | Ratio  | Amount                                                  | Ratio | Under Prompt Corrective Action Provisions | Ratio |
| <b>June 30, 2018</b>                                   |            |        |                                                         |       |                                           |       |
| Total Capital (to risk-weighted assets)                |            |        |                                                         |       |                                           |       |
| Salisbury                                              | \$ 102,646 | 12.27% | \$ 66,906                                               | 8.0%  | \$ n/a                                    | —     |
| Bank                                                   | 99,666     | 11.92  | 66,906                                                  | 8.0   | 83,633                                    | 10.0% |
| Tier 1 Capital (to risk-weighted assets)               |            |        |                                                         |       |                                           |       |
| Salisbury                                              | 85,138     | 10.18  | 50,180                                                  | 6.0   | n/a                                       | —     |
| Bank                                                   | 92,158     | 11.02  | 50,180                                                  | 6.0   | 66,906                                    | 8.0   |
| Common Equity Tier 1 Capital (to risk-weighted assets) |            |        |                                                         |       |                                           |       |
| Salisbury                                              | 85,138     | 10.18  | 37,635                                                  | 4.5   | n/a                                       | —     |
| Bank                                                   | 92,158     | 11.02  | 37,635                                                  | 4.5   | 54,361                                    | 6.5   |
| Tier 1 Capital (to average assets)                     |            |        |                                                         |       |                                           |       |
| Salisbury                                              | 85,138     | 8.30   | 41,048                                                  | 4.0   | n/a                                       | —     |
| Bank                                                   | 92,158     | 8.98   | 41,048                                                  | 4.0   | 51,310                                    | 5.0   |
| December 31, 2017                                      |            |        |                                                         |       |                                           |       |
| Total Capital (to risk-weighted assets)                |            |        |                                                         |       |                                           |       |
| Salisbury                                              | \$ 98,920  | 12.94% | \$ 61,154                                               | 8.0%  | \$ n/a                                    | —     |
| Bank                                                   | 95,810     | 12.54  | 61,130                                                  | 8.0   | 76,413                                    | 10.0% |
| Tier 1 Capital (to risk-weighted assets)               |            |        |                                                         |       |                                           |       |
| Salisbury                                              | 82,034     | 10.73  | 45,865                                                  | 6.0   | n/a                                       | —     |
| Bank                                                   | 88,924     | 11.64  | 45,848                                                  | 6.0   | 61,130                                    | 8.0   |
| Common Equity Tier 1 Capital (to risk-weighted assets) |            |        |                                                         |       |                                           |       |
| Salisbury                                              | 82,034     | 10.73  | 34,399                                                  | 4.5   | n/a                                       | —     |
| Bank                                                   | 88,924     | 11.64  | 34,386                                                  | 4.5   | 49,668                                    | 6.5   |
| Tier 1 Capital (to average assets)                     |            |        |                                                         |       |                                           |       |
| Salisbury                                              | 82,034     | 8.53   | 38,461                                                  | 4.0   | n/a                                       | —     |
| Bank                                                   | 88,924     | 9.25   | 38,461                                                  | 4.0   | 48,076                                    | 5.0   |

### Cash Dividends to Common Shareholders

Salisbury's ability to pay cash dividends is substantially dependent on the Bank's ability to pay cash dividends to Salisbury. There are certain restrictions on the payment of cash dividends and other payments by the Bank to Salisbury. Under Connecticut law, the Bank cannot declare a cash dividend except from net profits, defined as the remainder of all earnings from current operations. The total of all cash dividends declared by the Bank in any calendar year shall not, unless specifically approved by the Banking Commissioner, exceed the total of its net profits of that year combined with its retained net profits of the preceding two years.

FRB Supervisory Letter SR 09-4, February 24, 2009, revised March 30, 2009, notes that, as a general matter, the Board of Directors of a Bank Holding Company ("BHC") should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of

earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the Federal Reserve reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the BHC capital structure.

**NOTE 8 – BENEFITS**

Salisbury's 401(k) Plan expense was \$238 thousand and \$187 thousand, respectively, for the three month periods ended June 30, 2018 and 2017, and \$520 thousand and \$472 thousand, respectively, for the six month periods ended June 30, 2018 and 2017. Other post-retirement benefit obligation expense for endorsement split-dollar life insurance arrangements was (\$24) thousand and \$17 thousand, respectively, for the three month periods ended June 30, 2018 and 2017, and \$2 thousand and \$36 thousand, respectively, for the six month periods ended June 30, 2018 and 2017. The credit in the current quarter reflected a reduction of the Bank's liability associated with split-dollar life insurance arrangements for employees who left the Bank in 2017.



## **ESOP**

Salisbury offers an ESOP to eligible employees. Under the Plan, Salisbury may make discretionary contributions to the Plan, which generally vests in full upon six years of qualified service. Salisbury's ESOP expense was \$66 thousand and \$15 thousand, respectively, for the three month periods ended June 30, 2018 and 2017, and \$127 thousand and \$49 thousand, respectively, for the six month periods ended June 30, 2018 and 2017.

## **Other Retirement Plans**

A Non-Qualified Deferred Compensation Plan (the "Plan") was adopted effective January 1, 2013. This Plan was adopted by the Bank for the benefit of certain key employees ("Executive" or "Executives") who have been selected and approved by the Bank to participate in this Plan and who have evidenced their participation by execution of a Non-Qualified Deferred Compensation Plan Participation Agreement ("Participation Agreement") in a form provided by the Bank. This Plan is intended to comply with Internal Revenue Code ("Code") Section 409A and any regulatory or other guidance issued under such Section. Salisbury's expense for this plan was \$28 thousand and \$21 thousand, respectively, for the three month periods ended June 30, 2018 and 2017, and \$57 thousand and \$41 thousand, respectively, for the six month periods ended June 30, 2018 and 2017.

On January 19, 2018, the Compensation Committee granted a total of 53,500 Phantom Stock Appreciation Units pursuant to the 2013 Phantom Stock Appreciation Unit and Long-Term Incentive Plan (the "Plan"), including 20,000 units to three Named Executive Officers. Mr. Cantele received 10,000 units, Mr. Davies received 5,000 units and Mr. Alberio received 5,000 units. The units will vest on the third anniversary of the grant date. Salisbury's expense for all Phantom Stock Appreciation Units was \$60 thousand and (\$8) thousand, respectively, for the three month periods ended June 30, 2018 and 2017, and \$120 thousand and \$35 thousand, respectively, for the six month periods ended June 30, 2018 and 2017.

## **Grants of Restricted Stock and Options**

### Restricted stock

Restricted stock expense was \$83 thousand and \$61 thousand, respectively, for the three month periods ended June 30, 2018 and 2017, and \$208 thousand and \$120 thousand, respectively, for the six month periods ended June 30, 2018 and 2017. In second quarter 2018, Salisbury granted a total of 13,210 shares of restricted stock to certain employees and Directors pursuant to its 2017 Long Term Incentive Plan. The fair value of the stock at grant date was \$585,000. The restricted stock will vest three years from the grant date. Unrecognized compensation cost relating to the awards as of June 30, 2018 and 2017 totaled \$983 thousand and \$738 thousand, respectively and as of March 31, 2018 and 2017 totaled \$493 thousand and \$288 thousand, respectively. There were no forfeitures in the second quarter of 2018 and 2017 and year to date for 2018 and 2017 there were 0 and 200 shares, respectively.

### Options

Salisbury issued stock options in conjunction with its acquisition of Riverside Bank in 2014. In the second quarter, there were 3,350 stock options exercised at \$31.11 by two employees and in the first quarter 2018, 1,350 stock options were exercised at \$31.11 per share by one former Riverside Bank executive, who is currently a Named Executive Officer of Salisbury. In the first quarter 2017, 12,150 stock options were exercised at \$25.93 by former Riverside Bank executives. No stock options were exercised in the second quarter 2017.

## **NOTE 9 – ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME**

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The components of accumulated other comprehensive (loss) income are as follows:

| (in thousands)                                                         | June 30, 2018 | December 31, 2017 |
|------------------------------------------------------------------------|---------------|-------------------|
| Unrealized (losses) gains on securities available-for-sale, net of tax | \$(846        | ) \$179           |
| Accumulated other comprehensive (loss) income, net                     | \$(846        | ) \$179           |

## NOTE 10 – FAIR VALUE OF ASSETS AND LIABILITIES

Salisbury uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, other assets are recorded at fair value on a nonrecurring basis, such as loans held for sale, collateral dependent impaired loans, property acquired through foreclosure or repossession and mortgage servicing rights. These nonrecurring fair value adjustments typically involve the application of lower-of-cost-or-market accounting or write-downs of individual assets.

Salisbury adopted ASC 820-10, “Fair Value Measurement - Overall,” which provides a framework for measuring fair value under generally accepted accounting principles. In accordance with ASC 820-10, Salisbury groups its financial assets and financial liabilities measured at fair value in three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. GAAP specifies a hierarchy of valuation techniques based on whether the types of valuation information (“inputs”) are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Salisbury's market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1. Quoted prices in active markets for identical assets. Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. Government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2. Significant other observable inputs. Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3. Significant unobservable inputs. Valuations for assets and liabilities that are derived from other methodologies, including option pricing models, discounted cash flow models and similar techniques, are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets and liabilities.

Salisbury adopted ASC 2016-01, “Financial Instruments – overall (subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities”, which requires the exit price notion to be used when measuring the fair value of financial instruments for disclosure. Salisbury estimated the fair value of its loan portfolio based on a loan-level assessment that incorporated probabilities of default by loan type and internal risk rating, product-level loss given defaults and prepayment rates as well as discount rates.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Salisbury did not have any significant transfers of assets between levels 1 and 2 of the fair value hierarchy during the six month period ended June 30, 2018.

Assets measured at fair value are as follows:

| (in thousands)                                                     | Fair Value Measurements Using |          |         | Assets at fair value |
|--------------------------------------------------------------------|-------------------------------|----------|---------|----------------------|
|                                                                    | Level 1                       | Level 2  | Level 3 |                      |
| June 30, 2018                                                      |                               |          |         |                      |
| Assets at fair value on a recurring basis                          |                               |          |         |                      |
| U.S. Government Agency notes                                       | \$—                           | \$2,504  | \$—     | \$2,504              |
| Municipal bonds                                                    | —                             | 2,529    | —       | 2,529                |
| Mortgage-backed securities:                                        |                               |          |         |                      |
| U.S. Government agencies and U.S. Government-sponsored enterprises | —                             | 35,164   | —       | 35,164               |
| Collateralized mortgage obligations:                               |                               |          |         |                      |
| U.S. Government agencies                                           | —                             | 13,496   | —       | 13,496               |
| Non-agency                                                         | —                             | 1,910    | —       | 1,910                |
| SBA bonds                                                          | —                             | 25,997   | —       | 25,997               |
| Corporate bonds                                                    | —                             | 3,457    | —       | 3,457                |
| Securities available-for-sale                                      | \$—                           | \$85,057 | \$—     | \$85,057             |
| CRA mutual funds                                                   | 825                           | —        | —       | 825                  |
| Assets at fair value on a non-recurring basis                      |                               |          |         |                      |
| Collateral dependent impaired loans                                | \$—                           | \$—      | \$4,980 | \$4,980              |
| Other real estate owned                                            | \$—                           | \$—      | \$478   | \$478                |
| December 31, 2017                                                  |                               |          |         |                      |
| Assets at fair value on a recurring basis                          |                               |          |         |                      |
| Municipal bonds                                                    | \$—                           | \$3,486  | \$—     | \$3,486              |
| Mortgage-backed securities:                                        |                               |          |         |                      |
| U.S. Government agencies and U.S. Government-sponsored enterprises | —                             | 45,868   | —       | 45,868               |
| Collateralized mortgage obligations:                               |                               |          |         |                      |
| U.S. Government agencies                                           | —                             | 10,377   | —       | 10,377               |
| Non-agency                                                         | —                             | 2,664    | —       | 2,664                |
| SBA bonds                                                          | —                             | 12,267   | —       | 12,267               |
| Corporate bonds                                                    | —                             | 3,550    | —       | 3,550                |
| Securities available-for-sale                                      | \$—                           | \$78,212 | \$—     | \$78,212             |
| CRA mutual funds                                                   | 835                           | —        | —       | 835                  |
| Assets at fair value on a non-recurring basis                      |                               |          |         |                      |
| Collateral dependent impaired loans                                | \$—                           | \$—      | \$5,863 | \$5,863              |
| Other real estate owned                                            | \$—                           | \$—      | \$719   | \$719                |

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Carrying values and estimated fair values of financial instruments are as follows:

| (in thousands)                                  | Carrying value | Estimated fair value | Fair value measurements using |         |           |
|-------------------------------------------------|----------------|----------------------|-------------------------------|---------|-----------|
|                                                 |                |                      | Level 1                       | Level 2 | Level 3   |
| June 30, 2018                                   |                |                      |                               |         |           |
| Financial Assets                                |                |                      |                               |         |           |
| Cash and cash equivalents                       | \$77,473       | \$77,473             | \$77,473                      | \$—     | \$—       |
| Securities available-for-sale, net              | 85,057         | 85,057               | —                             | 85,057  | —         |
| CRA mutual fund                                 | 825            | 825                  | 825                           | —       | —         |
| Federal Home Loan Bank of Boston stock          | 4,988          | 4,988                | —                             | —       | 4,988     |
| Loans held-for-sale                             | 206            | 208                  | —                             | —       | 208       |
| Loans receivable, net <sup>1</sup>              | 872,796        | 850,804              | —                             | —       | 850,804   |
| Accrued interest receivable                     | 3,025          | 3,025                | —                             | —       | 3,025     |
| Cash surrender value of life insurance policies | 14,544         | 14,544               | 14,544                        | —       | —         |
| Financial Liabilities                           |                |                      |                               |         |           |
| Demand (non-interest-bearing)                   | \$215,149      | \$215,149            | \$—                           | \$—     | \$215,149 |
| Demand (interest-bearing)                       | 147,120        | 147,120              | —                             | —       | 147,120   |
| Money market                                    | 228,918        | 228,918              | —                             | —       | 228,918   |
| Savings and other                               | 172,701        | 172,701              | —                             | —       | 172,701   |
| Certificates of deposit                         | 133,593        | 133,032              | —                             | —       | 133,032   |
| Deposits                                        | 897,481        | 896,920              | —                             | —       | 896,920   |
| Repurchase agreements                           | 1,691          | 1,691                | —                             | —       | 1,691     |
| FHLBB advances                                  | 79,538         | 79,647               | —                             | —       | 79,647    |
| Subordinated debt                               | 9,823          | 10,098               | —                             | —       | 10,098    |
| Note payable                                    | 297            | 308                  | —                             | —       | 308       |
| Capital lease liability                         | 3,147          | 3,442                | —                             | —       | 3,442     |
| Accrued interest payable                        | 222            | 222                  | —                             | —       | 222       |
| December 31, 2017                               |                |                      |                               |         |           |
| Financial Assets                                |                |                      |                               |         |           |
| Cash and cash equivalents                       | \$48,486       | \$48,486             | \$48,486                      | \$—     | \$—       |
| Securities available-for-sale, net              | 78,212         | 78,212               | —                             | 78,212  | —         |
| CRA mutual fund                                 | 835            | 835                  | 835                           | —       | —         |
| Federal Home Loan Bank of Boston stock          | 3,813          | 3,813                | —                             | —       | 3,813     |
| Loans held-for-sale                             | 669            | 669                  | —                             | —       | 669       |
| Loans receivable, net <sup>1</sup>              | 801,703        | 816,451              | —                             | —       | 816,451   |
| Accrued interest receivable                     | 2,665          | 2,665                | —                             | —       | 2,665     |
| Cash surrender value of life insurance policies | 14,381         | 14,381               | 14,381                        | —       | —         |
| Financial Liabilities                           |                |                      |                               |         |           |
| Demand (non-interest-bearing)                   | \$220,536      | \$220,536            | \$—                           | \$—     | \$220,536 |
| Demand (interest-bearing)                       | 142,575        | 142,575              | —                             | —       | 142,575   |
| Money market                                    | 190,953        | 190,953              | —                             | —       | 190,953   |
| Savings and other                               | 144,600        | 144,600              | —                             | —       | 144,600   |
| Certificates of deposit                         | 116,831        | 115,290              | —                             | —       | 115,290   |
| Deposits                                        | 815,495        | 813,954              | —                             | —       | 813,954   |
| Repurchase agreements                           | 1,668          | 1,668                | —                             | —       | 1,668     |
| FHLBB advances                                  | 54,422         | 54,918               | —                             | —       | 54,918    |
| Subordinated debt                               | 9,811          | 10,313               | —                             | —       | 10,313    |
| Note payable                                    | 313            | 341                  | —                             | —       | 341       |
| Capital lease liability                         | 1,835          | 2,161                | —                             | —       | 2,161     |

|                          |    |    |   |   |    |
|--------------------------|----|----|---|---|----|
| Accrued interest payable | 99 | 99 | — | — | 99 |
|--------------------------|----|----|---|---|----|

<sup>1</sup> In accordance with the prospective adoption of ASU No. 2016-01, the fair value of loans as of June 30, 2018 was measured using an exit price notion. The fair value of loans as of December 31, 2017 was measured using an entry price notion.

The carrying amounts of financial instruments shown in the above table are included in the consolidated balance sheets under the indicated captions or are included in accrued interest and other liabilities.

**NOTE 11 – SUBSEQUENT EVENTS**

On July 27, 2018 the Board of Directors declared a dividend of \$0.28 per common share payable on August 31, 2018 to shareholders of record as of August 11, 2018.

Item **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS**  
**2. OF OPERATIONS**

Management's Discussion and Analysis of Financial Condition and Results of Operations of Salisbury Bancorp, Inc. ("Salisbury" or the "Company") and its subsidiary should be read in conjunction with Salisbury's Annual Report on Form 10 K for the year ended December 31, 2017. Readers should also review other disclosures Salisbury files from time to time with the Securities and Exchange Commission (the "SEC").

**BUSINESS**

Salisbury Bancorp, Inc., a Connecticut corporation, formed in 1998, is the bank holding company for Salisbury Bank and Trust Company (the "Bank"), a Connecticut-chartered and Federal Deposit Insurance Corporation (the "FDIC") insured commercial bank headquartered in Lakeville, Connecticut. Salisbury's common stock is traded on the NASDAQ Capital Market under the symbol "SAL." Salisbury's principal business consists of its operation and control of the business of the Bank.

The Bank, formed in 1848, currently provides commercial banking, consumer financing, retail banking and trust and wealth advisory services through a network of fourteen banking offices and ten ATMs located in: Litchfield County, Connecticut; Dutchess, Orange and Ulster Counties, New York; and Berkshire County, Massachusetts and through its internet website (salisburybank.com). In April 2018, the Bank completed its purchase of the Fishkill, New York branch from Orange Bank & Trust Company and consolidated its existing Fishkill branch with the newly acquired branch.

Critical Accounting Policies and Estimates

Salisbury's consolidated financial statements follow GAAP as applied to the banking industry in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event.

Salisbury's significant accounting policies are presented in Note 1 of Notes to Consolidated Financial Statements, which, along with this Management's Discussion and Analysis, provide information on how significant assets are valued in the financial statements and how those values are determined. Management believes that the following accounting estimates are the most critical to aid in fully understanding and evaluating Salisbury's reported financial results, and they require management's most difficult, subjective or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain.

*Loans*

Loans acquired in business combinations are initially recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of the loans involves estimating the amount and timing of cash flows initially expected to be collected and discounting those cash flows at an appropriate market rate of interest. The Bank continues to evaluate reasonableness of the timing and the amount of cash to be collected. Subsequent decreases in expected cash flows may result in changes in the amortization or accretion of fair market value adjustments, and in some cases may result in the loan being considered impaired. Such decreases may also result in recognition of

additional provisions to the allowance for loan losses. For collateral dependent loans with deteriorated credit quality, the Bank estimates the fair value of the underlying collateral of the loans. These values are discounted using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral.

*Allowance for Loan Losses*

The allowance for loan losses represents management's estimate of credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the balance sheet. A discussion of the factors driving changes in the amount of the allowance for loan losses is included in the "Provision and Allowance for Loan Losses" section of Management's Discussion and Analysis.



### *Goodwill and Intangible Assets*

Management evaluates goodwill and identifiable intangible assets for impairment annually using valuation techniques that involve estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based on changes in economic conditions and other factors. Future events or changes in the estimates, which are used to determine the carrying value of goodwill and identifiable intangible assets or which otherwise adversely affect their value or estimated lives could have a material adverse impact on the results of operations.

### *Available-For-Sale Securities*

Management evaluates securities for other-than-temporary impairment giving consideration to the extent to which the fair value has been less than cost, estimates of future cash flows, delinquencies and default severity, and the intent and ability of Salisbury to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The consideration of the above factors is subjective and involves estimates and assumptions about matters that are inherently uncertain. Should actual factors and conditions differ materially from those used by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

### *Revenue Recognition*

Revenue is recognized when, or as, obligations under the terms of a contract are satisfied, which occurs when control of the promised products or services is transferred to customers. Revenue is measured as the amount of consideration Salisbury expects to receive in exchange for transferring products or services to a customer ("transaction price"). To the extent the transaction price includes variable consideration, Salisbury estimates the amount of variable consideration that should be included in the transaction price utilizing the most likely amount to which Salisbury expects to be entitled. Variable consideration is included in the transaction price if, in Salisbury's judgment, it is probable that a significant future reversal of cumulative revenue under the contract will not occur. Estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of Salisbury's anticipated performance and all information (historical, current, and forecasted) that is reasonably available. Sales, value add, and other taxes collected on behalf of third parties are excluded from revenue.

When determining the transaction price of a contract, an adjustment is made if payment from a customer occurs either significantly before or significantly after performance, resulting in a significant financing component. Applying the practical expedient in paragraph 606-10-32-18, Salisbury does not assess whether a significant financing component exists if the period between when Salisbury performs its obligations under the contract and when the customer pays is one year or less. None of the Salisbury's contracts contained a significant financing component as of June 30, 2018.

Contracts with customers may contain multiple performance obligations. For such arrangements, the transaction price is allocated to each performance obligation based on the estimated relative standalone selling prices of the promised products or services underlying each performance obligation. Salisbury determines standalone selling prices based on the price at which the performance obligation is sold separately. If the standalone selling price is not observable through fee schedules provided to its customers or through past transactions, Salisbury estimates the standalone selling price taking into account available information such as market conditions and internally approved pricing guidelines related to the performance obligations.

Contracts are often modified to account for changes in contract specifications and requirements. Contract modifications exist when the modification either creates new or changes the existing enforceable rights and obligations. Generally, contract modifications are for products or services that are distinct from the existing contract

and are accounted for as if they were a new and separate contract. The original contract is still accounted for according to its original terms.

Product revenue is generally recognized when the customer obtains control of Salisbury's product, which occurs at a point in time, and are generally upon completion of the service based on the terms of a contract. Service revenue is generally recognized over time as the services are delivered to the customer. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the products or services to be provided. Salisbury generally measures its progress based on the right to invoice. Salisbury uses the right to invoice measure of progress when Salisbury has a right to invoice the customer for an amount that corresponds directly with the value to the customer of Salisbury's performance to date. Under the right to invoice measure of progress, revenues are recorded equal to the amount Salisbury could invoice the customer. The right to invoice is generally determined by the passage of time during which the service is performed.

### *Trust and Wealth Advisory*

The Trust and Wealth Advisory business generates revenue through a range of fiduciary services including trust and estate administration, wealth advisory, and investment management to individuals, families, businesses and institutions. Revenue from these services are generally recognized over time and is typically based on a right to invoice measure of progress (output method). Certain fees, such as real estate sale fees, asset liquidation fees, special asset fees, and daily money management fees, are recorded as revenue at a point in time at the completion of the service.

### *Customer Deposit Fees*

The Customer Deposit business offers a variety of deposit accounts with a range of interest rates and other terms, which are designed to meet customer financial needs. Additional depositor related services provided to customers include Landlord/Tenant Lease Security Accounts and Services, Payroll Services, Cash Management (Remote Deposit Capture, ACH Origination, Wire Transfers and Positive Pay), ATM, Bank-by-Phone, Internet Banking, Internet Bill Pay, Person to Person Payments, Bank to Bank Transfers, Mobile Banking with remote deposit, and Online Financial Management with Account Aggregation Services. Monthly deposit account fees and account research fees are recognized over time using the right to invoice measure of progress. Overdraft protection, ATM services, cash management, bill pay, money transfers, among others, are generally recognized at point in time at the completion of the service.

### *Interchange Fees*

Salisbury earns interchange fee revenue through customers' use of the Bank's debit cards. Interchange fees are generally recognized as revenue at a point in time when customers make a purchase using their debit card.

### *Transaction Price Allocated to Future Performance Obligations*

ASC 606 requires that Salisbury disclose the aggregate amount of transaction price that is allocated to performance obligations that have not yet been satisfied as of June 30, 2018. The guidance provides certain practical expedients that limit this requirement and, therefore, Salisbury does not disclose the value of unsatisfied performance obligations for (1) contracts with an original expected length of one year or less and (2) contracts for which revenue is recognized at the amount to which Salisbury has the right to invoice for services performed. All revenue accounted for under the scope of ASC 606 meets one of these two criteria.

## **FINANCIAL CONDITION**

### **Securities and Short Term Funds**

During the first six months of 2018, securities increased \$8.0 million to \$90.9 million at June 30, 2018. Cash and cash equivalents (non-time interest-bearing deposits with other banks, money market funds and federal funds sold) increased \$29.0 million to \$77.5 million at June 30, 2018.

Salisbury evaluates securities for OTTI where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers its intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

Salisbury evaluates securities for strategic fit and may reduce its position in securities, although it is not more likely than not that Salisbury will be required to sell securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider any of its securities, other than four non-agency CMO securities reflecting OTTI, to be OTTI at June 30, 2018. As of June 30, 2018 one of these positions reflected a loss of \$16 thousand while the remaining three positions reflected an unrealized gain of \$32 thousand.

Salisbury has, and continues to monitor, CMO securities where historical recognition of losses has occurred as a result of OTTI. Salisbury determined, as of June 30, 2018, that additional recognition of OTTI was not required. It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI.

**Loans**

Net loans receivable increased \$71.1 million to \$872.8 million at June 30, 2018, compared with \$801.7 million at December 31, 2017. Gross loans receivable increased \$71.5 million to \$878.7 million at June 30, 2018, compared with \$807 million at December 31, 2017. The increase in gross loans primarily reflected growth in the commercial real estate of \$24.6 million, commercial and industrial loans of \$18.2 million and residential mortgages of \$26.4 million. Salisbury acquired approximately \$8 million of loans as a result of the completion of its purchase of Orange Bank & Trust Company's Fishkill, N.Y. branch during the second quarter 2018.

**Asset Quality**

During the first six months of 2018, non-performing assets decreased \$1.0 million primarily from the payoff of certain non-performing loans and write-downs on OREO properties of \$54 thousand. During the first six months of 2018, total impaired and potential problem loans decreased by \$0.6 million to \$23.3 million, or 2.66% of gross loans receivable at June 30, 2018, from \$24.0 million, or 2.97% of gross loans receivable at December 31, 2017.

Salisbury has cooperative relationships with the vast majority of its non-performing loan customers. Substantially all non-performing loans are collateralized with real estate and the repayment of such loans is largely dependent on the return of such loans to performing status or the liquidation of the underlying real estate collateral. Salisbury pursues the resolution of all non-performing loans through collections, restructures, voluntary liquidation of collateral by the borrower and, where necessary, legal action. When attempts to work with a customer to return a loan to performing status, including restructuring the loan, are unsuccessful, Salisbury will initiate appropriate legal action seeking to acquire property by deed in lieu of foreclosure or through foreclosure, or to liquidate business assets.

**Past Due Loans**

Loans past due 30 days or more decreased \$2.6 million for the six months ended June 30, 2018 to \$6.5 million, or 0.74% of gross loans receivable compared with \$9.1 million, or 1.13% of gross loans receivable at December 31, 2017.

The components of loans past due 30 days or greater are as follows:

| (in thousands)                          | June 30, 2018 | December 31, 2017 |
|-----------------------------------------|---------------|-------------------|
| Past due 30-59 days                     | \$970         | \$2,594           |
| Past due 60-89 days                     | 539           | 942               |
| Past due 90-179 days                    | 359           | 31                |
| Past due 180 days and over              | —             | —                 |
| Accruing loans                          | 1,868         | 3,567             |
| Past due 30-59 days                     | 37            | 1,186             |
| Past due 60-89 days                     | —             | 684               |
| Past due 90-179 days                    | 1,303         | 516               |
| Past due 180 days and over              | 3,275         | 3,164             |
| Non-accrual loans                       | 4,615         | 5,550             |
| Total loans past due 30 days or greater | \$6,483       | \$9,117           |

**Credit Risk Ratings**

Salisbury assigns credit risk ratings to loans receivable in order to manage credit risk and to determine the allowance for loan losses. Credit risk ratings categorize loans by common financial and structural characteristics that measure the credit strength of a borrower. Salisbury's rating model has eight risk rating grades, with each grade corresponding to a

progressively greater risk of default. Grades 1 through 4 are pass ratings and 5 through 8 are ratings (special mention, substandard, doubtful, and loss) defined by the bank's regulatory agencies, the FDIC and CTDOB. Risk ratings are assigned to differentiate risk within the portfolio and are reviewed on an ongoing basis and revised, if needed, to reflect changes in the borrowers' current financial position and outlook, risk profiles and the related collateral and structural positions.

Loans risk rated as "special mention" possess credit deficiencies or potential weaknesses deserving management's close attention that if left uncorrected may result in deterioration of the repayment prospects for the loans at some future date.

Loans risk rated as "substandard" are loans where the Bank's position is clearly not protected adequately by borrower current net worth or payment capacity. These loans have well defined weaknesses based on objective evidence and include loans where future losses to the Bank may result if deficiencies are not corrected, and loans where the primary source of repayment such as income is diminished and the Bank must rely on sale of collateral or other secondary sources of collection.

Loans risk rated as "doubtful" have the same weaknesses as substandard loans with the added characteristic that the weakness makes collection or liquidation in full, given current facts, conditions, and values, to be highly improbable. The possibility of loss is high, but due to certain important and reasonably specific pending factors, which may work to strengthen the loan, its reclassification as an estimated loss is deferred until its exact status can be determined.

Loans risk rated as "loss" are considered uncollectible and of such little value that continuance as Bank assets is unwarranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this loan even though partial recovery may be made in the future. Management actively reviews and tests its credit risk ratings against actual experience and engages an independent third-party to annually validate its assignment of credit risk ratings. In addition, the Bank's loan portfolio and risk ratings are examined annually on a rotating basis by its two primary regulatory agencies, the FDIC and CTDOB.

### Credit Quality Segments

Salisbury categorizes loans receivable into the following credit quality segments:

Impaired loans consist of all non-accrual loans and troubled debt restructured loans, and represent loans for which it is probable that Salisbury will not be able to collect all principal and interest amounts due according to the contractual terms of the loan agreements.

Non-accrual loans, a sub-set of impaired loans, are loans for which the accrual of interest has been discontinued because, in the opinion of management, full collection of principal or interest is unlikely.

Non-performing loans consist of non-accrual loans, and accruing loans past due 90 days and over that are well collateralized, in the process of collection and where full collection of principal and interest is reasonably assured.

Non-performing assets consist of non-performing loans plus real estate acquired in settlement of loans.

Troubled debt restructured loans are loans for which concessions such as reduction of interest rates, other than normal market rate adjustments, or deferral of principal or interest payments, extension of maturity dates, or reduction of principal balance or accrued interest, have been granted due to a borrower's financial condition. Loan restructuring is employed when management believes the granting of a concession will increase the probability of the full or partial collection of principal and interest.

- Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and are not classified as impaired.

### Impaired Loans

Loans individually evaluated for impairment (impaired loans) are loans for which Salisbury does not expect to collect all contractual principal and interest in accordance with the contractual terms of the loan. Impaired loans include all modified loans classified as troubled debt restructurings (TDRs) and loans on non-accrual status. The components of impaired loans are as follows:

| (in thousands)                                                | June 30, 2018 | December 31, 2017 |
|---------------------------------------------------------------|---------------|-------------------|
| Non-accrual loans, excluding troubled debt restructured loans | \$5,334       | \$5,450           |
| Non-accrual troubled debt restructured loans                  | 189           | 1,154             |

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|                                                              |          |          |
|--------------------------------------------------------------|----------|----------|
| Accruing troubled debt restructured loans                    | 8,387    | 7,482    |
| Total impaired loans                                         | \$13,910 | \$14,086 |
| Commitments to lend additional amounts to impaired borrowers | \$—      | \$—      |

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Non-Performing Assets

Non-performing assets decreased \$1.0 million to \$6.4 million, or 0.58% of assets at June 30, 2018, from \$7.4 million, or 0.75% of assets at December 31, 2017.

The 13.5% decrease in non-performing assets in the first six months 2018 resulted primarily from loan payoffs of \$1.8 million and a reduction of \$0.2 million in real estate acquired in settlement of loans, partly offset by \$1.3 million of loans placed on non-accrual.

The components of non-performing assets are as follows:

| (in thousands)                              | June 30, 2018 | December 31, 2017 |
|---------------------------------------------|---------------|-------------------|
| Residential 1-4 family                      | \$2,052       | \$2,045           |
| Residential 5+ multifamily                  | 145           | 151               |
| Home equity lines of credit                 | 60            | 66                |
| Commercial                                  | 2,675         | 3,622             |
| Farm land                                   | 230           | 250               |
| Vacant land                                 | —             | —                 |
| Real estate secured                         | 5,162         | 6,134             |
| Commercial and industrial                   | 360           | 470               |
| Consumer                                    | —             | —                 |
| Non-accruing loans                          | 5,522         | 6,604             |
| Accruing loans past due 90 days and over    | 359           | 31                |
| Non-performing loans                        | 5,881         | 6,635             |
| Real estate acquired in settlement of loans | 478           | 719               |
| Non-performing assets                       | \$6,359       | \$7,354           |

The past due status of non-performing loans is as follows:

| (in thousands)             | June 30, 2018 | December 31, 2017 |
|----------------------------|---------------|-------------------|
| Current                    | \$905         | \$1,054           |
| Past due 30-59 days        | 37            | 1,186             |
| Past due 60-89 days        | —             | 684               |
| Past due 90-179 days       | 1,663         | 546               |
| Past due 180 days and over | 3,276         | 3,165             |
| Total non-performing loans | \$5,881       | \$6,635           |

At June 30, 2018, 15.39% of non-performing loans were current with respect to loan payments, compared with 15.89% at December 31, 2017.

Troubled Debt Restructured Loans

Troubled debt restructured loans improved slightly during first six months 2018 to \$8.6 million, or 0.98% of gross loans receivable at June 30, 2018, compared to \$8.6 million, or 1.07% of gross loans receivable at December 31, 2017.

The components of troubled debt restructured loans are as follows:

| (in thousands)                               | June 30, 2018 | December 31, 2017 |
|----------------------------------------------|---------------|-------------------|
| Residential 1-4 family                       | \$3,495       | \$3,138           |
| Residential 5+ multifamily                   | 1,539         | 1,595             |
| Home equity lines of credit                  | 47            | 47                |
| Personal                                     | —             | —                 |
| Vacant land                                  | 194           | 199               |
| Commercial                                   | 2,964         | 2,454             |
| Real estate secured                          | 8,239         | 7,433             |
| Commercial and industrial                    | 148           | 49                |
| Accruing troubled debt restructured loans    | 8,387         | 7,482             |
| Residential 1-4 family                       | 44            | 269               |
| Residential 5+ multifamily                   | 145           | 151               |
| Commercial                                   | —             | 624               |
| Real estate secured                          | 189           | 1,044             |
| Commercial and Industrial                    | —             | 110               |
| Non-accrual troubled debt restructured loans | 189           | 1,154             |
| Troubled debt restructured loans             | \$8,576       | \$8,636           |

The past due status of troubled debt restructured loans is as follows:

| (in thousands)                               | June 30, 2018 | December 31, 2017 |
|----------------------------------------------|---------------|-------------------|
| Current                                      | \$7,920       | \$7,293           |
| Past due 30-59 days                          | 467           | 189               |
| Past due 60-89 days                          | —             | —                 |
| Accruing troubled debt restructured loans    | 8,387         | 7,482             |
| Current                                      | 189           | 530               |
| Past due 30-59 days                          | —             | —                 |
| Past due 60-89 days                          | —             | 624               |
| Past due 90-179 days                         | —             | —                 |
| Past due 180 days and over                   | —             | —                 |
| Non-accrual troubled debt restructured loans | 189           | 1,154             |
| Total troubled debt restructured loans       | \$8,576       | \$8,636           |

At June 30, 2018, 94.55% of troubled debt restructured loans were current with respect to loan payments, as compared with 90.59% at December 31, 2017.

Potential Problem Loans

Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and are not classified as impaired. Potential problem loans decreased \$0.5 million during the first six months of 2018 to \$9.4 million, or 1.07% of gross loans receivable at June 30, 2018, compared with \$9.9 million, or 1.23% of gross loans receivable at December 31, 2017.

The components of potential problem loans are as follows:

| (in thousands)                         | June 30, 2018 | December 31, 2017 |
|----------------------------------------|---------------|-------------------|
| Residential 1-4 family                 | \$2,120       | \$1,432           |
| Residential 5+ multifamily             | —             | —                 |
| Construction of residential 1-4 family | —             | —                 |
| Home equity lines of credit            | 459           | 104               |
| Residential real estate                | 2,579         | 1,536             |
| Commercial                             | 6,475         | 7,905             |
| Construction of commercial             | —             | —                 |
| Commercial real estate                 | 6,475         | 7,905             |
| Farm land                              | —             | —                 |
| Vacant land                            | —             | —                 |
| Real estate secured                    | 9,054         | 9,441             |
| Commercial and industrial              | 384           | 457               |
| Consumer                               | —             | —                 |
| Total potential problem loans          | \$9,438       | \$9,898           |

The past due status of potential problem loans is as follows:

| (in thousands)                | June 30, 2018 | December 31, 2017 |
|-------------------------------|---------------|-------------------|
| Current                       | \$8,985       | \$8,520           |
| Past due 30-59 days           | 22            | 1,291             |
| Past due 60-89 days           | 72            | 56                |
| Past due 90-179 days          | 359           | 31                |
| Total potential problem loans | \$9,438       | \$9,898           |

At June 30, 2018, 95.2% of potential problem loans were current with respect to loan payments, as compared with 86.1% at December 31, 2017. Management cannot predict the extent to which economic or other factors may impact such borrowers' future payment capacity, and there can be no assurance that such loans will not be placed on nonaccrual status, restructured, or require increased provisions for loan losses.

**Deposits and Borrowings**

Deposits increased \$82.0 million during 2018, or 10.0%, to \$897.4 million at June 30, 2018, compared with \$815.5 million at December 31, 2017. Retail repurchase agreements balance stayed constant at \$1.7 million at June 30, 2018 and December 31, 2017. Salisbury acquired approximately \$8 million in deposits as a result of the completion of its purchase of Orange Bank & Trust Company's Fishkill, N.Y branch during the second quarter 2018. Total deposits at June 30, 2018 included three relationships totaling approximately \$73 million, or 8.1% of total deposits. Approximately \$38 million of this total was deposited on June 28, 2018 and related to a Trust & Wealth client. These funds were expected to be used by the client to fund the purchase of securities for their account in July 2018.

The distribution of average total deposits by account type is as follows:

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| (in thousands)                     | June 30, 2018   |          |                                | December 31, 2017 |          |                                | Weighted |  |
|------------------------------------|-----------------|----------|--------------------------------|-------------------|----------|--------------------------------|----------|--|
|                                    | Average Balance | Percent  | Weighted Average Interest Rate | Average Balance   | Percent  | Weighted Average Interest Rate |          |  |
| Demand deposits                    | \$215,385       | 25.40 %  | 0.00 %                         | \$216,164         | 26.83 %  | 0.00 %                         |          |  |
| Interest-bearing checking accounts | 145,913         | 17.21    | 0.28                           | 135,756           | 16.85    | 0.23                           |          |  |
| Regular savings accounts           | 176,680         | 20.84    | 0.61                           | 145,779           | 18.09    | 0.29                           |          |  |
| Money market savings               | 183,620         | 21.66    | 0.60                           | 191,407           | 23.76    | 0.36                           |          |  |
| Certificates of deposit            | 126,246         | 14.89    | 1.12                           | 116,608           | 14.47    | 0.90                           |          |  |
| Total deposits                     | \$847,844       | 100.00 % | 0.47 %                         | \$805,714         | 100.00 % | 0.31 %                         |          |  |

The classification of certificates of deposit by interest rates is as follows:

| Interest rates (in thousands) | June 30, 2018 | December 31, 2017 |
|-------------------------------|---------------|-------------------|
| Less than 1.00%               | \$46,331      | \$50,226          |
| 1.00% to 1.99%                | 58,206        | 52,558            |
| 2.00% to 2.99%                | 29,056        | 14,047            |
| 3.00% to 3.99%                | —             | —                 |
| 4.00% to 4.99%                | —             | —                 |
| Total                         | \$133,593     | \$116,831         |

The distribution of certificates of deposit by interest rate and maturity is as follows:

| Interest rates  | At June 30, 2018               |                            |                              |                       | Total     | Percent of Total |
|-----------------|--------------------------------|----------------------------|------------------------------|-----------------------|-----------|------------------|
|                 | Less Than or Equal to One Year | More Than One to Two Years | More Than Two to Three Years | More Than Three Years |           |                  |
| Less than 1.00% | \$39,011                       | \$7,317                    | \$2                          | \$1                   | \$46,331  | 34.68 %          |
| 1.00% to 1.99%  | 32,092                         | 9,826                      | 7,740                        | 8,548                 | 58,206    | 43.57            |
| 2.00% to 2.99%  | 10,319                         | 7,413                      | 5,660                        | 5,664                 | 29,056    | 21.75            |
| 3.00% to 3.99%  | —                              | —                          | —                            | —                     | —         | 0.00             |
| 4.00% to 4.99%  | —                              | —                          | —                            | —                     | —         | 0.00             |
| Total           | \$81,422                       | \$24,556                   | \$13,402                     | \$14,213              | \$133,593 | 100.00 %         |

Scheduled maturities of time certificates of deposit in denominations of \$100,000 or more are as follows:

| June 30, 2018 (in thousands)               | Within 3 months | Within 3-6 months | Within 6-12 months | Over 1 year | Total    |
|--------------------------------------------|-----------------|-------------------|--------------------|-------------|----------|
| Certificates of deposit \$100,000 and over | \$8,017         | \$14,610          | \$16,561           | \$28,703    | \$67,891 |

FHLBB advances increased \$25.1 million during 2018 to \$79.5 million at June 30, 2018, compared with \$54.4 million at December 31, 2017. The increase was primarily due to advances totaling \$82.0 million entered into during the first six months of 2018 which mature in less than one year. These advances were partly offset by the maturity of \$25 million of advances in 2018. Salisbury has an Irrevocable Letter of Credit Reimbursement Agreement with the FHLBB, whereby upon the Bank's request an irrevocable letter of credit is issued to secure municipal and certain other transactional deposit accounts. These letters of credit are secured primarily by residential mortgage loans. The amount of funds available from the FHLBB to the Bank is reduced by any letters of credit outstanding. At June 30, 2018, \$27 million of letters of credit were outstanding.

## Liquidity

Salisbury manages its liquidity position to ensure that there is sufficient funding availability at all times to meet both anticipated and unanticipated deposit withdrawals, loan originations and advances, securities purchases and other operating cash outflows. Salisbury's primary sources of liquidity are principal payments and maturities of securities and loans, short-term borrowings through repurchase agreements and FHLBB advances, net deposit growth and funds provided by operations. Liquidity can also be provided through sales of loans and available-for-sale securities.

Salisbury manages its liquidity in accordance with a liquidity funding policy, and also maintains a contingency funding plan that provides for the prompt and comprehensive response to unexpected demands for liquidity. Management believes Salisbury's funding sources will meet anticipated funding needs.

Operating activities for the six-month period ended June 30, 2018 provided net cash of \$5.8 million. Investing activities utilized net cash of \$74 million principally from \$63.4 million of net loan originations and principal collections, \$27.4 million of purchases of securities available-for-sale and FHLBB stock and \$1.1 million of capital expenditures, partly offset by proceeds of \$9.7 from calls and maturities of securities available-for-sale and \$8.7 million from the sale of available-for-sale-securities. Financing activities provided net cash of \$97.2 million, principally due to an increase in deposits of \$56.9 million, FHLBB advances of \$52.0 million, an increase in time deposits of \$16.8 million, partly offset by principal payments on FHLBB advances of \$27 million.

At June 30, 2018, Salisbury had outstanding commitments to fund new loan originations of \$78.4 million and unused lines of credit of \$128.3 million. Salisbury believes that these commitments can be met in the normal course of business. Salisbury believes that its liquidity sources will continue to provide funding sufficient to support operating activities, loan originations and commitments, and deposit withdrawals.

**RESULTS OF OPERATIONS****For the three month periods ended June 30, 2018 and 2017**OVERVIEW

Net income allocated to common stock was \$1.9 million, or \$0.68 per common share, for the second quarter ended June 30, 2018 (second quarter 2018), compared with \$1.9 million, or \$0.68 per common share, for the second quarter ended June 30, 2017 (second quarter 2017), and \$2.0 million, or \$0.72 per common share, for the first quarter ended March 31, 2018 (first quarter 2018).

Net Interest Income

Tax equivalent net interest income for the second quarter 2018 increased \$48 thousand, or 0.5%, versus first quarter 2018, and increased \$267 thousand, or 3.3%, versus second quarter 2017. Average earning assets increased \$46.6 million versus first quarter 2018, and increased \$102.8 million versus second quarter 2017. Average total interest bearing deposits increased \$25.6 million versus first quarter 2018 and increased \$55.6 million versus second quarter 2017. The average total interest bearing deposits for second quarter 2018 reflected the \$38 million deposit by the Trust & Wealth client deposited on June 28, 2018. The increase in average interest bearing deposits from the first quarter 2018 partly reflected the acquisition of the Fishkill N.Y. branch in April 2018, which increased deposits by approximately \$8 million. The increase in average interest bearing deposits from the second quarter 2017 partly reflected the acquisition of the New Paltz, N.Y. branch in June 2017, which increased deposits by approximately \$31 million. The tax equivalent net interest margin for the second quarter 2018 was 3.31% compared with 3.46% for the first quarter 2018 and 3.58% for the second quarter 2017. The decline in the net interest margin primarily reflected the higher cost of borrowing from the FHLB and the repricing of deposits at higher interest rates.

The following table sets forth the components of Salisbury's fully tax-equivalent ("FTE") net interest income and yields on average interest-earning assets and interest-bearing liabilities.

| Three months ended June 30,<br>(dollars in thousands) | Average Balance |           | Income /<br>Expense |         | Average Yield /<br>Rate |        |
|-------------------------------------------------------|-----------------|-----------|---------------------|---------|-------------------------|--------|
|                                                       | 2018            | 2017      | 2018                | 2017    | 2018                    | 2017   |
| Loans (a)(d)                                          | \$860,575       | \$774,028 | \$9,116             | \$8,308 | 4.24 %                  | 4.29 % |
| Securities (c)(d)                                     | 84,575          | 76,493    | 569                 | 517     | 2.69                    | 2.70   |
| FHLBB stock                                           | 5,006           | 3,904     | 53                  | 36      | 4.23                    | 3.69   |
| Short term funds (b)                                  | 36,648          | 29,627    | 128                 | 58      | 1.40                    | 0.78   |
| Total earning assets                                  | 986,804         | 884,052   | 9,866               | 8,919   | 4.00                    | 4.04   |
| Other assets                                          | 54,317          | 56,109    |                     |         |                         |        |
| Total assets                                          | \$1,041,121     | \$940,161 |                     |         |                         |        |
| Interest-bearing demand deposits                      | \$145,913       | \$131,968 | 101                 | 81      | 0.28                    | 0.25   |
| Money market accounts                                 | 183,618         | 187,278   | 275                 | 159     | 0.60                    | 0.34   |
| Savings and other                                     | 176,680         | 141,691   | 267                 | 85      | 0.60                    | 0.24   |
| Certificates of deposit                               | 126,246         | 115,882   | 354                 | 253     | 1.12                    | 0.87   |
| Total interest-bearing deposits                       | 632,457         | 576,819   | 997                 | 578     | 0.63                    | 0.40   |
| Repurchase agreements                                 | 2,107           | 1,419     | 1                   | 1       | 0.19                    | 0.28   |
| Capital lease                                         | 3,161           | 433       | 48                  | 20      | 6.07                    | 18.48  |
| Note payable                                          | 300             | 330       | 4                   | 5       | 5.33                    | 6.06   |

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|                                           |             |           |         |         |      |      |
|-------------------------------------------|-------------|-----------|---------|---------|------|------|
| Subordinated Debt (net of issuance costs) | 9,820       | 9,796     | 156     | 156     | 6.35 | 6.37 |
| FHLBB advances                            | 74,886      | 40,269    | 500     | 266     | 2.67 | 2.64 |
| Total interest-bearing liabilities        | 722,731     | 629,066   | 1,706   | 1,026   | 0.94 | 0.65 |
| Demand deposits                           | 213,926     | 208,670   |         |         |      |      |
| Other liabilities                         | 5,472       | 6,359     |         |         |      |      |
| Shareholders' equity                      | 98,992      | 96,066    |         |         |      |      |
| Total liabilities & shareholders' equity  | \$1,041,121 | \$940,161 |         |         |      |      |
| Net interest income                       |             |           | \$8,160 | \$7,893 |      |      |
| Spread on interest-bearing funds          |             |           |         |         | 3.05 | 3.38 |
| Net interest margin (e)                   |             |           |         |         | 3.31 | 3.58 |

(a) Includes non-accrual loans.

(b) Includes interest-bearing deposits in other banks and federal funds sold.

(c) Average balances of securities are based on historical cost.

(d) Includes tax exempt income benefit of \$117,000 and \$121,000, respectively, for 2018 and 2017 on tax-exempt securities and loans whose income and yields are calculated on a tax-equivalent basis.

(e) Net interest income divided by average interest-earning assets.



The following table sets forth the changes in FTE interest due to volume and rate.

| Three months ended June 30, (in thousands) | 2018 versus 2017 |         |       |
|--------------------------------------------|------------------|---------|-------|
| Change in interest due to                  | Volume           | Rate    | Net   |
| Loans                                      | \$923            | \$(115) | \$808 |
| Securities                                 | 54               | (2 )    | 52    |
| FHLBB stock                                | 11               | 6       | 17    |
| Short term funds                           | 19               | 51      | 70    |
| Interest-earning assets                    | 1,007            | (60 )   | 947   |
| Deposits                                   | 72               | 347     | 419   |
| Repurchase agreements                      | —                | —       | —     |
| Capital lease                              | 84               | (56 )   | 28    |
| Note payable                               | —                | (1 )    | (1 )  |
| Subordinated Debt                          | —                | —       | —     |
| FHLBB advances                             | 230              | 4       | 234   |
| Interest-bearing liabilities               | 386              | 294     | 680   |
| Net change in net interest income          | \$621            | \$(354) | \$267 |

#### Interest Income

Tax equivalent interest income increased \$947 thousand to \$9.9 million for second quarter 2018 as compared with second quarter 2017. Loan income as compared to second quarter 2017 increased \$808 thousand, or 9.7%, primarily due to an \$86.5 million, or 11.2%, increase in average loans. Tax equivalent securities income increased \$52 thousand, or 10.1%, for second quarter 2018 as compared with second quarter 2017, primarily due to an \$8.0 million, or 10.6%, increase in average balances. Income on short-term funds as compared to second quarter 2017 increased \$70 thousand, or 120.7%, primarily due to a \$7.0 million, or 23.7%, increase in average short-term funds and a 62 basis point increase in the average short-term funds yields.

#### Interest Expense

Interest expense increased \$680 thousand to \$1.7 million for second quarter 2018 as compared with second quarter 2017. Interest on deposit accounts increased \$419 thousand, or 72.5%, as a result of a \$55.6 million increase in the average balances and an average increase in deposit rates of 23 basis points as compared with second quarter 2017. Interest expense on FHLBB borrowings increased \$234 thousand as a result of an average balance increase of \$34.6 million as compared with second quarter 2017, as well as a higher average borrowings rate which increased 3 basis points. Interest expense on subordinated debt totaled \$156 thousand for the second quarter in both 2018 and 2017.

#### Provision and Allowance for Loan Losses

The provision for loan losses was \$467 thousand for second quarter 2018, compared with \$364 thousand for second quarter 2017. Net loan charge-offs were \$144 thousand and \$156 thousand for the respective quarters.

The following table details the principal categories of credit quality ratios:

| Three months ended June 30,                                   | 2018   | 2017   |
|---------------------------------------------------------------|--------|--------|
| Net charge-offs to average loans receivable, gross            | 0.02 % | 0.02 % |
| Non-performing loans to loans receivable, gross               | 0.67   | 1.01   |
| Accruing loans past due 30-89 days to loans receivable, gross | 0.18   | 0.38   |
| Allowance for loan losses to loans receivable, gross          | 0.84   | 0.83   |

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|                                                   |        |       |
|---------------------------------------------------|--------|-------|
| Allowance for loan losses to non-performing loans | 125.51 | 82.87 |
| Non-performing assets to total assets             | 0.58   | 1.20  |

Reserve coverage, as measured by the ratio of the allowance for loan losses to gross loans, increased to 0.84% at June 30, 2018 compared to 0.83% at June 30, 2017. The increase in the ratio of the allowance for loan losses to non-performing loans to 125.51% at June 30, 2018 from 82.87% at June 30, 2017 primarily reflected the payoff of a non-performing loan during first quarter 2018.

Non-performing loans (non-accrual loans plus accruing loans past-due 90 days or more) amounted to \$5.9 million, or 0.67% of gross loans receivable at June 30, 2018 as compared to \$7.8 million, or 1.01%, at June 30, 2017. Accruing loans past due 30-89 days decreased \$2.0 million to \$1.5 million, or 0.18% of gross loans receivable from \$3.0 million, or 0.38% of gross loans receivable, at June 30, 2017. See “Financial Condition – Loan Credit Quality” above for further discussion and analysis.

The allowance for loan losses represents management's estimate of the probable credit losses inherent in the loan portfolio as of the reporting date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged off, and is reduced by loan charge-offs. Loan charge-offs are recognized when management determines a loan, or portion of a loan, to be uncollectible. The allowance for loan losses is computed by segregating the portfolio into three components: (1) loans collectively evaluated for impairment: general loss allocation factors for non-impaired loans are segmented into pools of loans based on similar risk characteristics such as loan product, collateral type and loan-to-value, loan risk rating, historical loss experience, delinquency factors and other similar economic indicators, (2) loans individually evaluated for impairment: individual loss allocations for loans deemed to be impaired based on discounted cash flows or collateral value, and (3) unallocated: general loss allocations for other environmental factors.

Impaired loans and certain potential problem loans, when warranted, are individually evaluated for impairment. Impairment is measured for each individual loan, or for a borrower's aggregate loan exposure, using either the fair value of the collateral, less estimated costs to sell if the loan is collateral dependent, or the present value of expected future cash flows discounted at the loan's effective interest rate. A specific allowance is generally established when the collateral value or discounted cash flows of the loan is lower than the carrying value of that loan.

The component of the allowance for loan losses for loans collectively evaluated for impairment is estimated by stratifying loans into segments and credit risk ratings and then applying management's general loss allocation factors. The general loss allocation factors are based on expected loss experience adjusted for historical loss experience and other qualitative factors, including levels or trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. The qualitative factors are determined based on the various risk characteristics of each loan segment. There were no significant changes in Salisbury's policies or methodology pertaining to the general component of the allowance for loan losses during the first six months of 2018.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management's estimate of probable losses. It reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio. Additionally reserves are established for off balance sheet exposures.

Determining the adequacy of the allowance and reserves at any given period is difficult, particularly during deteriorating or uncertain economic periods, and management must make estimates using assumptions and information that are often subjective and changing rapidly. The review of credit exposure related to loans is a continuing event in light of a changing economy and the dynamics of the banking and regulatory environment. Should the economic climate deteriorate, borrowers could experience difficulty and the level of non-performing loans, charge-offs and delinquencies could rise, requiring increased provisions and reserves. In management's judgment, Salisbury remains adequately reserved both against total loans and non-performing loans at June 30, 2018.

Management's loan risk rating assignments, loss percentages and specific reserves are subjected annually to an independent credit review by an external firm. In addition, the Bank is examined annually on a rotational basis by one of its two primary regulatory agencies, the FDIC and CTDOB. As an integral part of their examination process, the FDIC and CTDOB review the adequacy and methodology of the Bank's credit risk ratings and allowance for loan losses.

#### Non-Interest Income

The following table details the principal categories of non-interest income.

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| Three months ended June 30, (dollars in thousands) | 2018    | 2017    | 2018 vs.<br>2017 |         |   |
|----------------------------------------------------|---------|---------|------------------|---------|---|
| Trust and wealth advisory                          | \$949   | \$892   | \$57             | 6.4     | % |
| Service charges and fees                           | 892     | 902     | (10)             | (1.1)   | ) |
| (Losses) gains on sales of mortgage loans, net     | (1 )    | 30      | (31)             | (103.3) | ) |
| Mortgage servicing, net                            | 84      | 31      | 53               | 171.0   |   |
| Losses on CRA mutual fund                          | (7 )    | —       | (7)              | 100.00  |   |
| Gain(Losses) on available-for-sale securities, net | 17      | (14 )   | 31               | (221.4) | ) |
| Other                                              | 124     | 110     | 14               | 12.7    |   |
| Total non-interest income                          | \$2,058 | \$1,951 | \$107            | 5.5     | % |

Non-interest income for second quarter 2018 increased \$107 thousand versus second quarter 2017. Trust and Wealth Advisory increased \$57 thousand versus second quarter 2017. The year-over-year increase primarily reflected higher asset-based fees and higher estate settlement fees. Assets under administration were \$668 million as of June 30, 2018 compared with \$600 million at March 31, 2018 and \$586 million as of June 30, 2017. Service charges and fees decreased \$10 thousand versus second quarter 2017 as higher interchange fees were offset by lower deposit and other fees. Income from sales of mortgage loans decreased \$31 thousand versus second quarter 2017. No mortgage loans were sold during the second quarter 2018 compared with sales of \$1.6 million for second quarter 2017. Mortgage servicing fees increased \$53 thousand compared with second quarter 2017 on lower amortization expense for mortgage servicing rights. Second quarter 2018 and second quarter 2017 included mortgage servicing amortization and periodic impairment charges (net) of \$11 thousand and \$68 thousand, respectively. Gains/(losses) on sales of securities during the second quarter 2018 were \$17 thousand compared with \$(14) thousand in second quarter 2017. Unrealized losses on an investment in a CRA mutual fund were \$(7) thousand in the current quarter. Prior to first quarter 2018, gains and losses on equity investments were included in shareholders' equity. Other income includes bank owned life insurance income and rental income.

### Non-Interest Expense

The following table details the principal categories of non-interest expense.

| Three months ended June 30, (dollars in thousands) | 2018    | 2017    | 2018 vs. 2017 |         |
|----------------------------------------------------|---------|---------|---------------|---------|
| Salaries                                           | \$2,939 | \$2,668 | \$271         | 10.16 % |
| Employee benefits                                  | 969     | 831     | 138           | 16.61   |
| Premises and equipment                             | 1,101   | 907     | 194           | 21.39   |
| Data processing                                    | 556     | 504     | 52            | 10.32   |
| Professional fees                                  | 611     | 764     | (153)         | (20.03) |
| OREO gains, losses and write-downs                 | 1       | —       | 1             | —       |
| Collections and other real estate owned            | 235     | 155     | 80            | 51.61   |
| FDIC insurance                                     | 123     | 98      | 25            | 25.51   |
| Marketing and community support                    | 222     | 152     | 70            | 46.05   |
| Amortization of core deposit intangibles           | 116     | 126     | (10)          | (7.94)  |
| Other                                              | 544     | 546     | (2)           | (0.37)  |
| Non-interest expense                               | \$7,417 | \$6,751 | \$666         | 9.87 %  |

Non-interest expense for second quarter 2018 increased \$666 thousand versus second quarter 2017. Total compensation expense increased \$409 thousand in the current year's quarter as compared to the same period in the prior year. The increase is mainly attributable to the mix and levels of staff, higher production accruals reflecting higher loan origination volume, and higher ESOP, 401K and deferred compensation expense, partly offset by lower charges related to bank owned life insurance. Premises and equipment expense increased \$194 thousand versus second quarter 2017. The year-over-year increase primarily reflected lease and depreciation expense as well as other operating costs associated with the new Newburgh and Fishkill, N.Y. branches as well the New Paltz, N.Y. branch, which was acquired in June 2017. Data processing expense increased \$52 thousand versus second quarter 2017. The year over year increase primarily reflected higher core system charges and higher data communications expenses, partly offset by lower Trust & Wealth data processing charges. Professional fees decreased \$153 thousand versus second quarter 2017 on lower audit accruals and consultation fees. The second quarter 2018 also included one-time legal and consultation expenses of approximately \$75 thousand related to the acquisition of the Fishkill, N.Y. branch from Orange Bank & Trust Company. Collections, OREO and loan related expenses increased \$80 thousand versus second quarter 2017. The year over year increase is substantially attributable to delinquent real estate taxes on foreclosed properties and higher appraisal costs and mortgage taxes. The increase in marketing and community

support primarily reflects costs associated with the new Newburgh, N.Y. and Fishkill, N.Y. branch locations.

Income Taxes

The effective income tax rates for second quarter 2018 and second quarter 2017 were 14.35% and 24.63%, respectively. Generally, fluctuations in the effective tax rate result from changes in the mix of taxable and tax exempt income. Additionally, in December 2017, the federal statutory tax rate was reduced from 34% to 21%. Salisbury's effective tax rate is generally less than the federal statutory rate due to holdings of tax-exempt municipal bonds and loans as well as bank owned life insurance.

Salisbury did not incur Connecticut income tax in 2018 (to date) or 2017, other than minimum state income tax, as a result of a Connecticut law that permits banks to shelter certain mortgage income from the Connecticut corporation business tax through the use of a special purpose entity called a Passive Investment Company or PIC. In 2004, Salisbury availed itself of this benefit by forming a PIC, SBT Mortgage Service Corporation. Salisbury's income tax provision reflects the full impact of the Connecticut legislation. Salisbury does not expect to pay other than minimum state income tax in the foreseeable future unless there is a change in Connecticut tax law.

**For the six month periods ended June 30, 2018 and 2017**Overview

Net income allocated to common stock was \$3.9 million, or \$1.40 per common share, for the six month period ended June 30, 2018 (six month period 2018), compared with \$3.5 million, or \$1.26 per common share, for the six month period ended June 30, 2017 (six month period 2017).

Net Interest Income

Tax equivalent net interest income for the six month period 2018 increased \$284 thousand, or 1.8%, versus the six month period 2017. Average earning assets increased \$79.3 million versus the six month period 2017. Average total interest bearing deposits increased \$46.3 million versus the six month period 2017. The net interest margin of 3.39% decreased 25 basis points versus 3.68% for the six month period 2017. The decline in the net interest margin primarily reflected the higher cost of borrowing from the FHLB and the repricing of deposits at higher interest rates.

The following table sets forth the components of Salisbury's fully tax-equivalent ("FTE") net interest and dividend income and yields on average interest-earning assets and interest-bearing liabilities.

| Six months ended June 30,<br>(dollars in thousands) | Average Balance |                                                                                  | Income / Expense |          | Average Yield / Rate |        |
|-----------------------------------------------------|-----------------|----------------------------------------------------------------------------------|------------------|----------|----------------------|--------|
|                                                     | 2018            | 2017                                                                             | 2018             | 2017     | 2018                 | 2017   |
| Loans (a)(d)                                        | \$840,802       | \$771,620                                                                        | \$17,874         | \$16,710 | 4.25 %               | 4.33 % |
| Securities (c)(d)                                   | 82,516          | 76,199                                                                           | 1,071            | 1,079    | 2.60                 | 2.83   |
| FHLBB stock                                         | 4,450           | 3,728                                                                            | 92               | 66       | 4.13                 | 3.54   |
| Short term funds (b)                                | 35,864          | 30,803                                                                           | 248              | 111      | 1.38                 | 0.72   |
| Total earning assets                                | 963,632         | 882,350                                                                          | 19,285           | 17,966   | 4.00                 | 4.07   |
| Other assets                                        | 53,530          | 55,513                                                                           |                  |          |                      |        |
| Total assets                                        | \$1,017,162     | \$937,863                                                                        |                  |          |                      |        |
| Interest-bearing demand deposits                    | \$145,459       | \$130,773                                                                        | 192              | 143      | 0.26                 | 0.22   |
| Money market accounts                               | 186,088         | 185,878                                                                          | 503              | 301      | 0.54                 | 0.32   |
| Savings and other                                   | 164,001         | 140,802                                                                          | 417              | 146      | 0.51                 | 0.21   |
| Certificates of deposit                             | 124,185         | 115,948                                                                          | 662              | 504      | 1.07                 | 0.87   |
| Total interest-bearing deposits                     | 619,733         | 573,401                                                                          | 1,774            | 1,094    | 0.57                 | 0.38   |
| Repurchase agreements                               | 2,366           | 1,672                                                                            | 3                | 1        | 0.25                 | 0.12   |
| Capital lease                                       | 2,563           | 425                                                                              | 83               | 37       | 6.48                 | 17.41  |
| Note payable                                        | 304             | 334                                                                              | 9                | 7        | 5.92                 | 4.19   |
| Subordinated Debt (net of issuance costs)           | 9,817           | 9,793                                                                            | 312              | 312      | 6.36                 | 6.37   |
| FHLBB advances                                      | 62,888          | 41,589                                                                           | 833              | 528      | 2.65                 | 2.54   |
| Total interest-bearing liabilities                  | 697,671         | 627,214                                                                          | 3,014            | 1,979    | 0.86                 | 0.63   |
| Demand deposits                                     | 215,349         | 208,865                                                                          |                  |          |                      |        |
| Other liabilities                                   | 5,675           | 6,148                                                                            |                  |          |                      |        |
| Shareholders' equity                                | 98,467          | 95,636                                                                           |                  |          |                      |        |
| Total liabilities & shareholders' equity            | \$1,017,162     | \$937,863                                                                        |                  |          |                      |        |
| Net interest income                                 |                 |                                                                                  | \$16,271         | \$15,987 |                      |        |
| Spread on interest-bearing funds                    |                 |                                                                                  |                  |          | 3.14                 | 3.44   |
| Net interest margin (e)                             |                 |                                                                                  |                  |          | 3.38                 | 3.62   |
|                                                     | (a)             | <i>Includes non-accrual loans.</i>                                               |                  |          |                      |        |
|                                                     | (b)             | <i>Includes interest-bearing deposits in other banks and federal funds sold.</i> |                  |          |                      |        |

(c) *Average balances of securities are based on historical cost.*

(d) *Includes tax exempt income benefit of \$236,000 and \$257,000, respectively for 2018 and 2017 on tax-exempt securities and loans whose income and yields are calculated on a tax-equivalent basis.*

(e) *Net interest income divided by average interest-earning assets.*



The following table sets forth the changes in FTE interest due to volume and rate.

| Six months ended June 30, (in thousands) | 2018 versus 2017 |         |         |
|------------------------------------------|------------------|---------|---------|
|                                          | Volume           | Rate    | Net     |
| Change in interest due to                |                  |         |         |
| Loans                                    | \$1,484          | \$(320) | \$1,164 |
| Securities                               | 86               | (94 )   | (8 )    |
| FHLBB stock                              | 14               | 12      | 26      |
| Short term funds                         | 27               | 110     | 137     |
| Interest-earning assets                  | 1,611            | (292)   | 1,319   |
| Deposits                                 | 111              | 569     | 680     |
| Repurchase agreements                    | 1                | 1       | 2       |
| Capital lease                            | 128              | (82 )   | 46      |
| Note payable                             | (1 )             | 3       | 2       |
| Subordinated Debt                        | 1                | (1 )    | —       |
| FHLBB advances                           | 276              | 29      | 305     |
| Interest-bearing liabilities             | 516              | 519     | 1,035   |
| Net change in net interest income        | \$1,095          | \$(811) | \$284   |

#### Interest Income

Tax equivalent interest income increased \$1.3 million to \$19.3 million for the six month period 2018 compared with the six month period 2017. Loan income, as compared to the six months of 2017, increased \$1.2 million or 7.0% primarily due to a \$69.2 million, or 9.0%, increase in average loans. The increase was partially offset by an 8 basis point decrease in the average loan yield. Tax equivalent securities income decreased \$8 thousand, or 7.4%, for the six month period 2018 as compared with the six month period 2017, primarily due to a 23 basis point decrease in average yield, partially offset by a \$6.3 million, or 8.3%, increase in average volume. Income on short-term funds as compared to six month period 2017 increased \$137 thousand, or 123.4%, primarily due to a \$5.1 million, or 16.4%, increase in average short-term funds and a 66 basis point increase in the average short-term funds yields.

#### Interest Expense

Interest expense increased \$1.0 million to \$3.0 million for the six month period 2018 compared with the six month period 2017. Interest on deposit accounts increased \$680 thousand, or 62.2%, as a result of a \$46.3 million increase in the average balances. Average deposit rates increased 19 basis point compared with the six month period 2017. Interest expense on FHLBB borrowings increased \$305 thousand, or 57.8%, as a result of an average balance increase of \$21.3 million compared with the six month period 2017 as well as an 11 basis point increase in the average borrowings rate. Interest expense on subordinated debt totaled \$312 thousand for the six month periods 2018 and 2017.

#### Provision and Allowance for Loan Losses

The provision for loan losses was \$793 thousand for the six month period ended June 30, 2018 as compared to \$716 thousand for the six month period ended June 30, 2017. Net loan charge-offs were \$187 thousand and \$350 thousand for the respective periods.

Reserve coverage at June 30, 2018, as measured by the ratio of allowance for loan losses to gross loans, at 0.84%, compares with 0.83% a year ago at June 30, 2017. During the first six months of 2018, non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) decreased \$0.8 million to \$5.9 million. Non-performing loans represent 0.67% of gross loans receivable, a decrease from 0.82% at December 31, 2017. At

June 30, 2018, accruing loans past due 30-89 days decreased \$2.0 million to \$1.5 million or 0.17% of gross loans receivable from 0.44% at December 31, 2017. See “Financial Condition – Loan Credit Quality” for further discussion and analysis.

Non-interest income

The following table details the principal categories of non-interest income.

| Six months ended June 30, (dollars in thousands)   | 2018    | 2017    | 2018 vs. 2017 |         |
|----------------------------------------------------|---------|---------|---------------|---------|
| Trust and wealth advisory                          | \$1,843 | \$1,746 | \$97          | 5.6 %   |
| Service charges and fees                           | 1,760   | 1,863   | (103)         | (5.5 )  |
| Gains on sales of mortgage loans, net              | 17      | 79      | (62 )         | (78.5 ) |
| Mortgage servicing, net                            | 167     | 76      | 91            | 119.7   |
| Losses on CRA mutual fund                          | (20 )   | —       | (20 )         | —       |
| Gain(Losses) on available-for-sale securities, net | 16      | (14 )   | 30            | (214.3) |
| Other                                              | 249     | 223     | 26            | 11.7    |
| Total non-interest income                          | \$4,032 | \$3,973 | \$59          | 1.5 %   |

Non-interest income for the six month period ended June 30, 2018 increased \$59 thousand versus the same period in 2017. Trust and wealth advisory revenues increased \$97 thousand mainly due to growth in asset based fees and estate settlement fees. Service charges and fees decreased \$103 thousand as lower ATM and other deposit fees were partly offset by higher interchange and lending-related fees. Income from sales of mortgage loans decreased \$62 thousand substantially due to lower gains on sales of fixed rate residential mortgage loans. Mortgage loans sales totaled \$0.7 million for the six month period ended June 30, 2018 and \$3.5 million for the six month period ended June 30, 2017. The six month periods ended June 30, 2018 and 2017 included mortgage servicing amortization of \$22 thousand and \$136 thousand, respectively. Other income includes bank owned life insurance income and rental income.

Non-interest expense

The following table details the principal categories of non-interest expense.

| Six months ended June 30, (dollars in thousands) | 2018     | 2017     | 2018 vs. 2017 |        |
|--------------------------------------------------|----------|----------|---------------|--------|
| Salaries                                         | \$5,785  | \$5,437  | \$348         | 6.4 %  |
| Employee benefits                                | 2,128    | 1,919    | 209           | 10.9   |
| Premises and equipment                           | 2,125    | 1,802    | 323           | 17.9   |
| Data processing                                  | 1,042    | 977      | 65            | 6.7    |
| Professional fees                                | 1,230    | 1,481    | (251)         | (16.9) |
| OREO gains, losses and write-downs               | 53       | 145      | (91 )         | (63.2) |
| Collections and other real estate owned          | 316      | 312      | 4             | 1.3    |
| FDIC insurance                                   | 253      | 247      | 6             | 2.4    |
| Marketing and community support                  | 463      | 403      | 60            | 14.9   |
| Amortization of core deposit intangible assets   | 236      | 253      | (16 )         | (6.3 ) |
| Other                                            | 965      | 1,079    | (116)         | (10.7) |
| Non-interest expense                             | \$14,596 | \$14,055 | \$541         | 3.8 %  |

Non-interest expense for the six month period ended June 30, 2018 increased \$541 thousand versus the same period in 2017. Salaries and benefits increased \$557 thousand primarily due to increased staffing levels, higher production accruals, reflecting higher loan volume, and higher ESOP, 401-K and deferred compensation accruals, partly offset by lower charges related to bank owned life insurance and health insurance. Premises and equipment increased \$323 thousand primarily due to operating costs related to the new Newburgh and Fishkill, N.Y. branches as well as the New Paltz, N.Y. branch, which was acquired in June 2017. Data processing increased \$65 thousand mainly due to expenses related to core processing and data communications expenses, which were partly offset by lower Trust data processing related expenses. The decrease in professional fees of \$251 thousand versus the six month period 2017 primarily reflected reductions in audit, legal and consultation fees. The six month period ended June 30, 2018 also included

one-time legal and consultation expenses of approximately \$75 thousand related to the acquisition of the Fishkill, N.Y. branch from Orange Bank & Trust Company. Collections, OREO and loan related expense decreased \$87 thousand as lower OREO carrying costs were partly offset by higher write-downs on OREO properties, higher appraisal costs and higher mortgage taxes. Salisbury had three foreclosed properties at June 30, 2017 and five at June 30, 2016. Marketing and community support increased \$60 thousand due primarily to an increase in general marketing campaigns. Amortization of core deposit intangible assets decreased \$16 thousand due to the aging off of expenses related to previous acquisitions. Other expenses decreased \$116 thousand mainly due to lower postage, printing and supply costs.

Income taxes

The effective income tax rates for the six month periods ended June 30, 2018 and June 30, 2017 were 16.31% and 25.73%, respectively. Fluctuations in the effective tax rate result from changes in the mix of taxable and tax exempt income. Additionally, in December 2017, the federal statutory tax rate was reduced from 34% to 21%. Salisbury's effective tax rate is generally less than the federal statutory rate due to holdings of tax-exempt municipal bonds, tax-exempt loans and bank owned life insurance and other tax advantaged assets.

**CAPITAL RESOURCES**

Shareholders' equity was \$99.2 million at June 30, 2018, up \$1.7 million from December 31, 2017. Book value and tangible book value per common share were \$35.38 and \$29.88, respectively, compared with \$35.01 and \$29.39, respectively, at December 31, 2017. Contributing to the increase in shareholders' equity for year-to-date 2018 was net income of \$3.9 million and issued stock of \$0.2 million, partially offset by other common stock dividends of \$1.6 million. Accumulated other comprehensive income consists of unrealized losses on securities available-for-sale, net of tax, of \$0.8 million as of June 30, 2018.

**Capital Requirements**

Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional and discretionary actions by the regulators that, if undertaken, could have a direct material effect on Salisbury's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Salisbury and the Bank must meet specific guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Salisbury and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Salisbury and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Salisbury and the Bank must meet specific guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices.

Under current regulatory definitions, Salisbury and the Bank meet all capital adequacy requirements to which they are subject and the Bank is considered to be well-capitalized. As a result, the Bank pays lower federal deposit insurance premiums than those banks that are not "well-capitalized." Requirements for classification as a well-capitalized institution and for minimum capital adequacy along with Salisbury's and the Bank's regulatory capital ratios are as follows:

|                                                        | June 30, 2018 |         | December 31, 2017 |         |
|--------------------------------------------------------|---------------|---------|-------------------|---------|
|                                                        | Salisbury     | Bank    | Salisbury         | Bank    |
| Total Capital (to risk-weighted assets)                | 12.27 %       | 11.92 % | 12.94 %           | 12.54 % |
| Tier 1 Capital (to risk-weighted assets)               | 10.18         | 11.02   | 10.73             | 11.64   |
| Common Equity Tier 1 Capital (to risk-weighted assets) | 10.18         | 11.02   | 10.73             | 11.64   |
| Tier 1 Capital (to average assets)                     | 8.30          | 8.98    | 8.53              | 9.25    |

A well-capitalized institution, which is the highest capital category for an institution as defined by the Prompt Corrective Action regulations issued by the FDIC and the FRB, is one which maintains a Total Risk-Based ratio of 10% or above, a Tier 1 Risk-Based ratio of 8% or above, a Common Equity Tier 1 ratio of 6.5% or above, and a Leverage ratio of 5% or above, and is not subject to any written order, written agreement, capital directive, or prompt corrective action directive to meet and maintain a specific capital level. Maintaining strong capital is essential to Salisbury and the Bank's safety and soundness. However, the effective management of capital resources requires

generating attractive returns on equity to build value for shareholders while maintaining appropriate levels of capital to fund growth, meet regulatory requirements and be consistent with prudent industry practices.

The Federal Reserve Board (FRB) and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for bank holding companies and their bank subsidiaries. Under the final rules, minimum requirements increased for both the quantity and quality of capital held by the Bank and Salisbury. The rules include a common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%, require a minimum ratio of Total capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer began phasing in January 1, 2016 at 0.625% of risk-weighted assets and increases each subsequent year by an additional 0.625% until reaching its final level of 2.50% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules.

The phase-in period for the final rules began for Salisbury and the Bank on January 1, 2015. As of June 30, 2018, the Company and the Bank met each of their capital requirements and the most recent notification from the FDIC categorized the Bank as "well-capitalized." There are no conditions or events since that notification that management believes have changed the Bank's category.

## Dividends

Salisbury paid \$1.561 million in common stock dividends during the six month period ended June 30, 2018.

On July 27, 2018, the Board of Directors of Salisbury declared a common stock dividend of \$0.28 per common share payable on August 31, 2018 to shareholders of record on August 17, 2018. Common stock dividends, when declared, will generally be paid the last Friday of February, May, August and November, although Salisbury is not obligated to pay dividends on those dates or at any other time.

Salisbury's ability to pay cash dividends is dependent on the Bank's ability to pay cash dividends to Salisbury. There are certain restrictions on the payment of cash dividends and other payments by the Bank to Salisbury. Under Connecticut law, the Bank cannot declare a cash dividend except from net profits, defined as the remainder of all earnings from current operations. The total of all cash dividends declared by the Bank in any calendar year shall not, unless specifically approved by the Banking Commissioner, exceed the total of its net profits of that year combined with its retained net profits of the preceding two years.

FRB Supervisory Letter SR 09-4, February 24, 2009, revised December 31, 2015, states that, as a general matter, the Board of Directors of a Bank Holding Company ("BHC") should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the Federal Reserve reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the BHC capital position.

Salisbury believes that the payment of common stock cash dividends is appropriate, provided that such payment considers Salisbury's capital needs, asset quality, and overall financial condition and does not adversely affect the financial stability of Salisbury or the Bank. The continued payment of common stock cash dividends by Salisbury will be dependent on Salisbury's future core earnings, financial condition and capital needs, regulatory restrictions, and other factors deemed relevant by the Board of Directors of Salisbury.

## **IMPACT OF INFLATION AND CHANGING PRICES**

Salisbury's consolidated financial statements and related notes thereto presented elsewhere in this Form 10-Q are prepared in conformity with GAAP, which require the measurement of financial condition and operating results in terms of historical dollars without considering changes in the relative purchasing power of money, over time, due to inflation. Unlike some other types of companies, the financial nature of Salisbury's consolidated financial statements is more clearly affected by changes in interest rates than by inflation. Interest rates do not necessarily fluctuate in the same direction or in the same magnitude as the prices of goods and services. However, inflation does affect Salisbury to some extent because, as prices increase, the money supply grows and interest rates are affected by inflationary expectations. There is no precise method, however, to measure the effects of inflation on Salisbury's consolidated financial statements. Accordingly, any examination or analysis of the financial statements should take into consideration the possible effects of inflation. Although not a material factor in recent years, inflation could impact earnings in future periods.

## **FORWARD-LOOKING STATEMENTS**

This Form 10-Q and future filings made by Salisbury with the Securities and Exchange Commission, as well as other filings, reports and press releases made or issued by Salisbury and the Bank, and oral statements made by executive officers of Salisbury and the Bank, may include forward-looking statements relating to such matters as:

- (a) assumptions concerning future economic and business conditions and their effect on the economy in general and on the markets in which Salisbury and the Bank do business; and
- (b) expectations for revenues and earnings for Salisbury and the Bank.

Such forward-looking statements are based on assumptions rather than historical or current facts and, therefore, are inherently uncertain and subject to risk. For those statements, Salisbury claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.



Salisbury notes that a variety of factors could cause the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may affect the operation, performance, development and results of Salisbury's and the Bank's business include the following:

- (a) the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Bank operates;
  - (b) changes in the legislative and regulatory environment that negatively impacts Salisbury and the Bank through increased operating expenses;
    - (c) increased competition from other financial and non-financial institutions;
    - (d) the impact of technological advances and cybersecurity matters;
    - (e) interest rate fluctuations; and
  - (f) other risks detailed from time to time in Salisbury's filings with the Securities and Exchange Commission.
- Such developments could have an adverse impact on Salisbury's and the Bank's financial position and results of operations.

### Item 3. **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Salisbury manages its exposure to interest rate risk through its Asset/Liability Management Committee (“ALCO”) using risk limits and policy guidelines to manage assets and funding liabilities to produce financial results that are consistent with Salisbury's liquidity, capital adequacy, growth, risk and profitability targets. Interest rate risk is the risk of a negative impact to future earnings due to changes in interest rates.

The ALCO manages interest rate risk using income simulation to measure interest rate risk inherent in Salisbury's financial instruments at a given point in time by showing the effect of interest rate shifts on net interest income over a 24-month horizon. In management's June 30, 2018 analysis, the simulations incorporate static growth assumptions over the simulation horizons for regulatory compliance and interest rate risk measurement purposes. In the dynamic growth scenarios, allowances are made for loan, deposit and security product mix shifts in selected interest rate scenarios, such as movements between lower rate savings and money market deposit accounts and higher rate time deposits, and changes in the reinvestment of loan and securities cash flows. Additionally, the simulations take into account the specific re-pricing, maturity and prepayment characteristics of differing financial instruments that may vary under different interest rate scenarios.

The ALCO reviews the simulation results to determine whether Salisbury's exposure to change in net interest income remains within established tolerance levels over the simulation horizons and to develop appropriate strategies to manage this exposure. Salisbury's tolerance levels for changes in net interest income in its income simulations varies depending on the magnitude of interest rate changes and level of risk-based capital. All changes are measured in comparison to the projected net interest income that would result from an “unchanged” rate scenario where interest rates remain stable over the forecast horizon. The ALCO also evaluates the directional trends of net interest income, net interest margin and other financial measures over the forecast horizon for consistency with its liquidity, capital adequacy, growth, risk and profitability targets.

ALCO uses four interest rate scenarios to evaluate interest risk exposure and may vary these interest rate scenarios to show the effect of steepening or flattening changes in yield curves as well as parallel changes in interest rates. At June 30, 2018, ALCO used the following interest rate scenarios: (1) unchanged interest rates; (2) immediately rising interest rates – immediate parallel upward shift in market interest rates of 300 basis points across the yield curve; (3) immediately falling interest rates – immediate parallel downward shift in market interest rates of 100 basis points across the yield curve; and (4) gradual and non-parallel increase in interest rates – upward shift in market interest rates ranging from 337 basis points for the 2-year Treasury rates to 284 basis points for the 10-year Treasury. Deposit rates are assumed to shift by lesser amounts due to their relative historical insensitivity to market interest rate movements.

Further, deposits are assumed to have certain minimum rate levels below which they will not fall. Income simulations do not reflect adjustments in strategy that the ALCO could implement in response to rate shifts.

As of June 30, 2018, net interest income simulations indicated that Salisbury's exposure to changing interest rates over the simulation horizons remained within its tolerance levels, except for year two in the immediately falling interest rate scenario.

The following table sets forth the estimated change in net interest income from an unchanged interest rate scenario over the periods indicated for changes in market interest rates using Salisbury's financial instruments as of June 30, 2018.

| As of June 30, 2018                                                    | Months 1-12 | Months 13-24 |
|------------------------------------------------------------------------|-------------|--------------|
| Immediately rising interest rates + 300bp (static growth assumptions)  | (12.50 )%   | (6.30 )%     |
| Immediately falling interest rates - 100bp (static growth assumptions) | 0.08        | (4.09 )      |
| Gradual and non-parallel increase + 400bp (static growth assumptions)  | (4.37 )     | (10.17 )     |

The negative exposure of net interest income to immediately and gradually rising rates as compared to the unchanged rate scenario results from a faster projected rise in the cost of funds versus income from earning assets, as relatively rate-sensitive money market and time deposits re-price faster than longer duration earning assets. The negative exposure of net interest income to immediately falling rates as compared to an unchanged rate scenario results from a greater decline in earning asset yields compared to rates paid on funding liabilities, as a result of faster prepayments on existing assets and lower reinvestment rates on future loans originated and securities purchased.

While the ALCO reviews simulation assumptions and back-tests simulation results to ensure that they are reasonable and current, income simulation may not always prove to be an accurate indicator of interest rate risk or future net interest margin. Over time, the re-pricing, maturity and prepayment characteristics of financial instruments and the composition of Salisbury's balance sheet may change to a different degree than estimated. Simulation modeling assumes Salisbury's expectation for future balance sheet growth, which is a function of the business environment and customer behavior. Another significant simulation assumption is the sensitivity of core savings deposits to fluctuations in interest rates. Income simulation results assume that changes in both core savings deposit rates and balances are related to changes in short-term interest rates. The assumed relationship between short-term interest rate changes and core deposit rate and balance changes used in income simulation may differ from the ALCO's estimates. Lastly, mortgage-backed securities and mortgage loans involve a level of risk that unforeseen changes in prepayment speeds may cause related cash flows to vary significantly in differing rate environments. Such changes could affect the level of reinvestment risk associated with cash flow from these instruments, as well as their market value. Changes in prepayment speeds could also increase or decrease the amortization of premium or accretion of discounts related to such instruments, thereby affecting interest income.

Salisbury also monitors the potential change in market value of its available-for-sale debt securities in changing interest rate environments. The purpose is to determine market value exposure that may not be captured by income simulation, but which might result in changes to Salisbury's capital and liquidity position. Results are calculated using industry-standard analytical techniques and securities data. Available-for-sale equity securities are excluded from this analysis because the market value of such securities cannot be directly correlated with changes in interest rates.

The following table summarizes the potential change in market value of available-for-sale debt securities resulting from immediate parallel rate shifts:

| As of June 30, 2018 (in thousands)       | Rates up 100bp | Rates up 200bp |
|------------------------------------------|----------------|----------------|
| U.S. Government Agency notes             | (161 )         | (322 )         |
| Municipal bonds                          | (91 )          | (176 )         |
| Mortgage backed securities               | (968 )         | (2,152 )       |
| Collateralized mortgage obligations      | (616 )         | (1,289 )       |
| SBA pools                                | (1,450 )       | (2,742 )       |
| Other                                    | (99 )          | (194 )         |
| Total available-for-sale debt securities | \$(3,385 )     | \$(6,875 )     |

## Item 4.

**CONTROLS AND PROCEDURES**Evaluation of Disclosure Controls and Procedures

Salisbury's management, including its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of Salisbury's disclosure controls and procedures as of June 30, 2018. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective as of June 30, 2018.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that the information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports filed under the Exchange Act is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls

In addition, based on an evaluation of its internal controls over financial reporting, no change in Salisbury's internal control over financial reporting occurred during the quarter ended June 30, 2018 that has materially affected, or is reasonably likely to materially affect, Salisbury's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

The Bank is involved in various claims and legal proceedings arising in the ordinary course of business, which management currently believes are not material, individually or in the aggregate, to the business, financial condition or operating results of Salisbury or any of its subsidiaries. There are no material pending legal proceedings, other than ordinary routine litigation incidental to the registrant's business, to which Salisbury is a party or of which any of its property is subject.

**Item 1A. RISK FACTORS**

During the six months ended June 30, 2018, there were no material changes to the risk factors previously disclosed in Salisbury's Annual Report on Form 10-K for the year ended December 31, 2017.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**Item 4. MINE SAFETY DISCLOSURES**

Not Applicable.

**Item 5. OTHER INFORMATION**

None.

Item 6. **EXHIBITS**

| Exhibit No. | Description                                                                                                                                                                                                                                                                       |
|-------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1         | Certificate of Incorporation of Salisbury Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of Registrant's 1998 Registration Statement on Form S-4 filed April 23, 1998, File No.: 33-50857).                                                                              |
| 3.1.1       | Amendment to Article Third of Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed March 11, 2009).                                                                                                                |
| 3.1.2       | Certificate of Amendment to Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed March 19, 2009).                                                                                                                  |
| 3.1.3       | Certificate of Amendment to Certificate of Incorporation for the Series B Preferred Stock (incorporated by reference to Registrant's Form 8-K filed on August 25, 2011).                                                                                                          |
| 3.1.4       | Certificate of Amendment to Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed October 30, 2014).                                                                                                                |
| 3.2         | Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 of Form 8-K filed November 25, 2014).                                                                                                                                                                       |
| 4.1         | Form of Subordinated Note, dated as of December 10, 2015, issued by Salisbury Bancorp, Inc. (incorporated by reference to Exhibit 4.1 of Registrant's Form 8-K filed December 10, 2015).                                                                                          |
| 10.1        | 2017 Long Term Incentive Plan adopted by the Board on February 24, 2017 and subject to approval by shareholders at Salisbury's 2017 Annual Meeting of Shareholders (incorporated by reference to Appendix A of the Registrant's definitive proxy statement filed April 10, 2017). |
| 10.2        | Amendment Number Three to 2011 Long Term Incentive Plan dated as of April 28, 2017 (incorporated by reference to Exhibit 10.2 of Form 10-Q filed May 15, 2017).                                                                                                                   |
| 21.1        | Subsidiaries of the Registrant.                                                                                                                                                                                                                                                   |
| 31.1        | Chief Executive Officer Certification Pursuant to 17 CFR 240.13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                        |
| 31.2        | Chief Financial Officer Certification Pursuant to 17 CF 240.13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                         |
| 32.1        | Chief Executive Officer and Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                       |

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**SALISBURY  
BANCORP, INC.**

August 8, 2018    By: /s/ Richard J. Cantele, Jr.  
Richard J. Cantele,  
Jr.,

President and Chief  
Executive Officer

August 8, 2018 By: /s/ Peter Albero  
Peter Albero,  
Executive Vice  
President and Chief  
Financial Officer